



State of Wisconsin
Department of Financial Institutions

Tony Evers, Governor

Kathy Blumenfeld, Secretary

February 4, 2019

Senator Howard L. Marklein
Chair, Committee on Agriculture, Finance and Financial Institutions
Room 8 South
State Capitol
PO Box 7882
Madison, WI 53707-7882

Representative Cindi Duchow
Chair, Committee on Financial Institutions
Room 221 North
State Capitol
PO Box 8952
Madison, WI 53708

Re: Germane modification to proposed rule

Dear Senator Marklein and Representative Duchow:

Pursuant to s. 227.19(4)(b)(3), Stats., enclosed please find a revised Rule Report to the Legislature regarding Clearinghouse Rule 17-063. The proposed rule repeals and recreates ch. DFI-CU 72 regarding commercial and member business loans.

The revised rule report clarifies a definition under proposed s. DFI-CU 72.01(3)(b)3. that the loan identified thereunder is one made by a federally insured credit union to another federally insured credit union. This clarification brings the proposed rule into conformity with the federal member business loan rule, 12 CFR Part 723.3.

Except for the change to this definition in the proposed rule, nothing else is changed in the rule report or any of the attachments to the report.

Sincerely,

A handwritten signature in cursive script that reads 'Mark Schlei'.

Mark Schlei
Deputy Chief Legal Counsel

encl

Office of the Secretary

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STATE OF WISCONSIN
OFFICE OF CREDIT UNIONS

RULE REPORT TO THE LEGISLATURE

Commercial and Member Business Loans
Chapter DFI-CU 72 / CR 17-063

Attached: Proposed rule, fiscal estimate and economic impact analysis and Clearinghouse report to agency.

Governor's approval: The governor approved this rule March 23, 2018.

Basis and purpose of the proposed rule: The proposed rule repeals and recreates ch. DFI-CU 72, Admin. Code, to reflect changes effective January 1, 2017 to the National Credit Union Administration's (NCUA's) member business loans and commercial lending rules, 12 C.F.R. Part 723. Prior to the revision, ch. DFI-CU 72 and 12 C.F.R. Part 723 were substantially similar. The proposed rule updates Wisconsin's rules to reflect revisions to its federal counterpart. Proposed changes strengthen a credit union's board of directors and management responsibilities; replace current loan-to-value requirements and portfolio limits with a risk-based approach; modify waiver requirements and processes for obtaining waivers; and calculate the member business loan cap as a multiple of net worth, and not as a percentage of assets.

Summary of comments, agency's response, and explanation of any modifications as a result of comments or testimony:

1. Request to add the limited exception that is found in the NCUA's rule, which exempts certain small credit unions that rarely do business lending from having to implement commercial lending policies and hiring lending staff who meet certain experience requirements.

Response: The Office of Credit Unions (OCU) decided not to incorporate the requested limited exception because the OCU believes any credit union wishing to offer commercial loans or member business loans should have a policy in place and management approval.

2. Request to add to proposed s. 72.09(2)(c) the examples in current s. 72.15(3) regarding documentation the OCU will consider for an exemption.

Response: The agency agreed and included the examples in the current rule into the proposed rule.

3. Request that s. DFI-CU 72.05 be titled 'Commercial Loan Policy' in parity with the Federal rule and to clarify expectation of enhanced risk management practices for commercial loans as defined in the rule, distinct from non-commercial member business loans, such as loans secured by 1-4 family non-owner occupied residential properties.

Response: The OCU decided not to incorporate this request because in essence the policy is a commercial and member business loan policy.

4. Request that s. DFI-CU 72.07(1) numerator be defined as total 'commercial loans' to one borrower or group of associated borrowers in parity with the federal rule and consistent with the commercial loan policy requirements.

Response: The agency agreed and replaced the reference to member business loans with commercial loans.

Persons appearing or registering for or against the rule at hearing:

Speaking in favor: Brett Thompson, WI Credit Union League; Adam Newman, Landmark Credit Union; Jim Wynn, Westconsin Credit Union; and Derek Freis, Simplicity Credit Union

Speaking against: None

Speaking for information purposes only: None

Registering in favor, but not speaking: Chris Allen, Fox Communities Credit Union; Colleen Woggen, Oakdale Credit Union; Val Mindak, Park City Credit Union; Tim Hoff, Community First Credit Union; John Nygaard, Community First Credit Union; Mark Kennedy, Summit Credit Union; Steve Wilder, Covantage Credit Union

Registering against, but not speaking: Jon Turke, Wisconsin Bankers Association

Attending for information only: Jeff Blauer, Coop Credit Union; Jackson Burgau, Heartland Credit Union

Changes to analysis or fiscal estimate: None.

Response to legislative council recommendations: The recommendations were adopted in whole.

Final regulatory flexibility analysis, changes to energy impact report, housing impact analysis, and response to any report prepared by the SBRRB: n/a



LCRC
FORM 2

WISCONSIN LEGISLATIVE COUNCIL RULES CLEARINGHOUSE

Scott Grosz
Clearinghouse Director

Terry C. Anderson
Legislative Council Director

Margit S. Kelley
Clearinghouse Assistant Director

Jessica Krivis-Rupflinger
Legislative Council Deputy Director

CLEARINGHOUSE REPORT TO AGENCY

[THIS REPORT HAS BEEN PREPARED PURSUANT TO S. 227.15, STATS. THIS IS A REPORT ON A RULE AS ORIGINALLY PROPOSED BY THE AGENCY; THE REPORT MAY NOT REFLECT THE FINAL CONTENT OF THE RULE IN FINAL DRAFT FORM AS IT WILL BE SUBMITTED TO THE LEGISLATURE. THIS REPORT CONSTITUTES A REVIEW OF, BUT NOT APPROVAL OR DISAPPROVAL OF, THE SUBSTANTIVE CONTENT AND TECHNICAL ACCURACY OF THE RULE.]

CLEARINGHOUSE RULE 17-063

AN ORDER to repeal and recreate ch. DFI-CU 72, relating to commercial and member business loans.

Submitted by **DEPARTMENT OF FINANCIAL INSTITUTIONS**

09-07-2017 RECEIVED BY LEGISLATIVE COUNCIL.
10-02-2017 REPORT SENT TO AGENCY.

SG:DWS

LEGISLATIVE COUNCIL RULES CLEARINGHOUSE REPORT

This rule has been reviewed by the Rules Clearinghouse. Based on that review, comments are reported as noted below:

1. STATUTORY AUTHORITY [s. 227.15 (2) (a)]
Comment Attached YES NO
2. FORM, STYLE AND PLACEMENT IN ADMINISTRATIVE CODE [s. 227.15 (2) (c)]
Comment Attached YES NO
3. CONFLICT WITH OR DUPLICATION OF EXISTING RULES [s. 227.15 (2) (d)]
Comment Attached YES NO
4. ADEQUACY OF REFERENCES TO RELATED STATUTES, RULES AND FORMS [s. 227.15 (2) (e)]
Comment Attached YES NO
5. CLARITY, GRAMMAR, PUNCTUATION AND USE OF PLAIN LANGUAGE [s. 227.15 (2) (f)]
Comment Attached YES NO
6. POTENTIAL CONFLICTS WITH, AND COMPARABILITY TO, RELATED FEDERAL REGULATIONS [s. 227.15 (2) (g)]
Comment Attached YES NO
7. COMPLIANCE WITH PERMIT ACTION DEADLINE REQUIREMENTS [s. 227.15 (2) (h)]
Comment Attached YES NO



WISCONSIN LEGISLATIVE COUNCIL RULES CLEARINGHOUSE

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Jessica Karls-Ruplinger
Legislative Council Deputy Director

CLEARINGHOUSE RULE 17-063

Comments

NOTE: All citations to “Manual” in the comments below are to the Administrative Rules Procedures Manual, prepared by the Legislative Reference Bureau and the Legislative Council Staff, dated December 2014.]

2. Form, Style and Placement in Administrative Code

a. The examples following proposed s. DFI-CU 72.01 (2) (a) appear to be substantive to the definition of “a person or entity engaged in a common enterprise” and should be included under subd. 3., rather than as an example following the clause.

b. The note following proposed s. DFI-CU 72.01 (2) (b) 2, appears to be substantive to the definition and should be included in the definition under subd. 2., rather than as a note following the clause.

c. The example following proposed s. DFI-CU 72.01 (5) (a) appears to be substantive to the definition of a “construction or development loan” and should be included under subds. 1. and 2., as appropriate, rather than as an example following the clause.

d. The examples following proposed ss. DFI-CU 72.03 (1) (e) 1. a. and 72.12 (2) also appear to be substantive to the definition of a “construction or development loan” and should be included under that subdivision, as appropriate, rather than as an example following the clause.

e. The proposed rule must have an effective date clause. [See s. 1.02 (4), Manual.]

5. Clarity, Grammar, Punctuation and Use of Plain Language

a. The portion of the definition proposed under s. DFI-CU 72.01 (5) (a) 2., refers back to the definition itself in a circular fashion. This creates unnecessary confusion and should be avoided. See Wisconsin Bill Drafting Manual, s. 2.03 (7) (b).

b. In the first sentence under proposed s. DFI-CU 72.02 (1), the word "to" should be inserted between "loan" and "any".

c. Numerous definitions throughout the proposed rule, including "common enterprise" in proposed s. DFI-CU 72.01 (4), "loan secured by a one- to four-family residential property" in proposed s. DFI-CU 72.01 (11), "loan secured by a vehicle manufactured for household use" in proposed s. DFI-CU 72.01 (12), and "prospective market value" in proposed DFI-CU 72.03 (1) (b), appear to include a number of substantive rule provisions within each definition. These provisions should be expressed as rule provisions rather than part of a definition. The proposed rule should be reviewed in its entirety with regard to inclusion of substantive rule provisions in definitions.

d. Under proposed s. DFI-CU 72.08 (3) (c), it is incorrect punctuation to include quotation marks and parentheses around the acronym "CAMELS". Also, see s. 1.01 (6), Manual, in regard to the avoidance of the use of parentheses.

Clearinghouse Rule 17-063

PROPOSED ORDER OF THE OFFICE OF CREDIT UNIONS REPEALING AND RECREATING RULES

The Wisconsin Office of Credit Unions proposes an order to repeal and recreate ch. DFI—CU 72 relating to commercial and member business loans.

The scope statement for this rule, SS 108-16, was approved by the governor on November 8, 2016, published in Register No. 731A2 on November 14, 2016, approved by the director of the office of credit unions on November 30, 2016, approved by the credit union review board on June 19, 2017, and approved by the governor March 23, 2018.

ANALYSIS

1. Statutes interpreted:

Sections 186.098 and 186.115, Stats.

2. Statutory Authority:

Sections 186.098(10), 186.115(2) and 186.235(8), Stats.

3. Explanation of agency authority:

Section 186.098(10), Stats., provides: “Loans to members secured by mortgages on real estate may be made subject to the rules prescribed by the office of credit unions.”

Section 186.115(2), Stats., provides: “The activities, powers, products and services that may be undertaken, exercised or offered by credit unions ... are limited to those specified by rule of the office of credit unions.”

Section 186.235(8), Stats., provides: “The office of credit unions shall, with the approval of the credit union review board, promulgate rules relating to the business of credit unions.”

4. Related statutes or rules:

Section 186.098 authorizes a credit union to make loans to members.

Ch. DFI—CU 72, Admin. Code, sets forth requirements for a credit union to make member business loans.

5. Plain language analysis:

The proposed rule repeals and recreates ch. DFI-CU 72, Admin. Code, to reflect changes effective January 1, 2017 to the National Credit Union Administration's (NCUA's) member business loans and commercial lending rules, 12 C.F.R. Part 723. Prior to the revision, ch. DFI-CU 72 and 12 C.F.R. Part 723 were substantially similar. The proposed rule updates Wisconsin's rules to reflect revisions to its federal counterpart. Proposed changes strengthen a credit union's board of directors and management responsibilities; replace current loan-to-value requirements and portfolio limits with a risk-based approach; modify waiver requirements and processes for obtaining waivers; and calculate the member business loan cap as a multiple of net worth, and not as a percentage of assets.

6. Summary of, and comparison with, existing or proposed federal regulation:

Existing federal regulations are contained in 12 C.F.R. Part 723. The federal rule applies to federally-chartered credit unions and to state-chartered credit unions in states that have adopted the federal rule. Wisconsin is one of seven states that have a state-specific rule. The other states are: Connecticut, Illinois, Maryland, Oregon, Texas and Washington. The proposed rule would revise Wisconsin's state-specific rule to reflect the recently revised federal rule. Provisions from revised 12 C.F.R. Part 723 that the office of credit unions seeks to incorporate into the repealed and recreated ch. DFI—CU 72 are as follows: policy and program responsibilities that a state-chartered credit union must adopt and implement as part of a safe and sound commercial lending program; a statutory limit on the aggregate amount of member business loans that a state-chartered credit union may make pursuant to 12 U.S.C. 1757a; the removal of prescriptive requirements and limitations – such as collateral and security requirements, equity requirements, and loan limits – to be replaced with a broad principles-based regulatory approach; and the elimination of a several waiver processes.

7. Comparison with rules in adjacent states:

Only Illinois has a comparable rule: Ill. Admin. Code title 38, s. 190.165. This rule gives Illinois state-chartered credit unions the authority to make business loans to members. Illinois has recently adopted a rule to revise this rule to reflect the recent revisions to 12 C.F.R. Part 723. Minnesota, Iowa and Michigan follow revised 12 C.F.R. Part 723 and have not adopted a comparable state-specific rule.

8. Summary of factual data and analytical methodologies:

The office of credit unions reviewed the revisions to 12 C.F.R. Part 723. Proposed changes to ch. DFI—CU 72 are based on these revisions as well as staff regulatory experience.

9. Analysis and supporting documents used to determine effect on small business:

Small credit unions will not be impacted by the proposed rule. Only 27 out of the 143 Wisconsin federally insured state chartered credit unions fall within the definition of a small business under s. 227.114(1), Stats. Typically these credit unions do not engage in the commercial lending anticipated by the proposed rule. Proposed requirements regarding a board of directors' management responsibilities and having a commercial loan policy in place are minimal and should

have little to no additional cost. (Note: the department used "assets" in lieu of "gross annual sales" as the closest approximation to determine the effect on small business under s. 227.114(1), Stats., because credit unions do not have gross annual sales.)

10. Anticipated costs incurred by private sector:

The office of credit unions does not anticipate any costs will be incurred by the private sector.

11. Effect on small business:

The proposed rule will have little to no effect on small business.

12. Agency contact person:

Kim Santos, Director, Office of Credit Unions, PO Box 14137, Madison, WI 53708-0137. Tel. (608) 267-2608; e-mail Kim.Santos@wisconsin.gov

13. Place where comments are to be submitted and deadline for submission:

Comments may be submitted to the contact person shown below no later than the date on which the public hearing on this proposed rule order is conducted. Information as to the place, date and time of the public hearing will be published in the Wisconsin Administrative Register.

By mail: Mark Schlei, Deputy Chief Legal Counsel, Department of Financial Institutions, PO Box 8861, Madison, WI 53708-8861.

By delivery: Mark Schlei, Deputy Chief Legal Counsel, Department of Financial Institutions, 201 W. Washington Avenue, Suite 500, Madison, WI 53703.

By e-mail: DFIRulesComments@wisconsin.gov

Via the department's website: <http://www.wdfi.org/statutes/ProposedRules.htm>

SECTION 1. Chapter DFI-CU 72 is repealed and recreated to read:

CHAPTER DFI-CU 72

COMMERCIAL AND MEMBER BUSINESS LOANS

DFI-CU 72.01 Definitions. In this chapter:

(1) "Amount," when referring to the amount of a business loan, includes all of 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)(a) "Associated borrower" means any of the following:

1. Any person or entity with a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower.

2. Any person or entity named as a borrower or debtor in a loan or extension of credit, including a drawer, endorser or guarantor.

3. Any person or entity engaged in a common enterprise with the borrower or deriving a direct benefit from the loan to the borrower.

(b) For partnerships, joint ventures and associations, "associated borrower" does not include any of the following:

1. A member or partner of the borrower who is a partnership, joint venture or association that has a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower, and a direct benefit and common enterprise do not exist.

2. A partnership, joint venture or association that has a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower who is a limited partner not held generally liable for the debts or actions of the partnership, joint venture or association. The borrower must be limited from general liability by the terms of a partnership or membership agreement valid under applicable law.

3. A member or partner of a partnership, joint venture or association that has a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower who is a member or partner of a partnership, joint venture or association, and a direct benefit and common enterprise does not exist.

(3)(a) "Commercial loan" means a loan, line of credit, letter of credit or letter of credit including unfunded commitments, and any interest a credit union obtains in these made by another lender to individuals, sole proprietorships, partnerships, corporations or other business enterprises for commercial, industrial, agricultural or professional purposes.

(b) "Commercial loan" does not include any of the following:

1. Loans for personal expenditure purposes.
2. Loan made by a corporate credit union.
3. Loans made by a federally insured credit union to another federally insured credit union.
4. Loans made by a credit union to a credit union service organization.
5. Loans secured by a one- to four- family residential property.
6. Loans fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions.
7. Loans secured by a vehicle manufactured for household use.
8. Loans that would otherwise meet the definition of commercial loan and are equal to or less than \$50,000 after calculating the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union held by a borrower or an associated borrower.

(4) "Common enterprise" means the expected source of repayment for each loan or extension of credit is the same for each borrower, and no individual borrower has another source of income from which the loan, together with the borrower's other obligations, may be fully repaid. An employer will not be treated as a source of repayment because of wages and salaries paid to an employee unless one of the following is met:

(a) The loans or extensions of credit are made to borrowers who are directly or indirectly related through common control, including where one borrower is directly or indirectly controlled by another borrower, and substantial financial interdependence exists between or

among the borrowers. Substantial financial interdependence exists if 50 percent or more of one borrower's gross receipts or gross expenditures, on an annual basis, are derived from transactions with another borrower. Gross receipts and expenditures include gross revenues or expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments.

(b) Separate borrowers obtain loans or extensions of credit to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests.

(5)(a) "Construction or development loan" means a financing agreement that enables the borrower to acquire property, including land or structures, or rights to property with the intent to construct, renovate or expand any of the following:

1. Income producing property, including residential housing for rent or sale.
2. A commercial building, including a building used for commercial, agricultural, industrial or other similar purposes.

(b) "Construction or development loan" does not include a loan to finance maintenance, repairs or improvements to an existing income producing property that does not change its use or materially impact the property.

(6) "Control" means a person or entity that directly or indirectly, or acting through or together with one or more persons or entities:

(a) Owns, controls or has the power to vote 25 percent or more of any class of voting securities of another person or entity;

(b) Controls, in any manner, the election of a majority of the directors, trustees or other persons exercising similar functions of another person or entity; or

(c) Has the power to exercise a controlling influence over the management or policies of another person or entity.

(7) "Credit risk rating system" means a formal process that identifies and assigns a relative credit risk score to each commercial loan in a credit union's portfolio using ordinal ratings to represent the degree of risk. The credit risk score is determined through an evaluation of quantitative factors based on financial performance and qualitative factors based on management, operational, market and business environmental factors.

(8) "Direct benefit" means the proceeds of a loan or extension of credit to a borrower, or assets purchased with those proceeds, that are transferred to another person or entity, other than in bona fide arm's-length transaction where the proceeds are used to acquire property, goods or services.

(9) "Director" means the director of the office of credit unions or an authorized representative.

(10) "Immediate family member" means a spouse or other family member living in the same household.

(11) "Loan secured by a one- to four- family residential property" means a loan that at origination is secured wholly or substantially by a lien on a one- to four- family residential property, and the lien is central to the extension of the credit or the borrower would not have been extended credit in the same amount or on terms as favorable without the lien. A loan is wholly or substantially secured by a lien on a one- to four- family residential property if the estimated value of the real estate collateral at origination, after deducting any senior liens held by others, is greater than 50 percent of the principal amount of the loan.

(12)(a) "Loan secured by a vehicle manufactured for household use" means a loan that at origination is secured wholly or substantially by a lien on a vehicle generally manufactured for

personal, family or household use and not used as a fleet vehicle or to carry fare-paying passengers, and the lien is central to the extension of credit. A lien is central to the extension of credit if the borrower would not have been extended credit in the same amount or on terms as favorable without the lien. A loan is wholly or substantially secured by a lien on a vehicle manufactured for household use if the estimated value of the collateral at origination, after deducting any senior liens held by others, is greater than 50 percent of the principal amount of the loan.

(b) Vehicles that are manufactured for personal, family or household use and not used as a fleet vehicle or to carry fare-paying passengers include a passenger car, minivan, sport-utility vehicle, pickup truck, or similar light or heavy-duty truck.

(13) "Loan-to-value ratio" or "LTV ratio" means, with respect to any item of collateral, the aggregate amount of all sums borrowed and secured by that collateral, including outstanding balances, plus any unfunded commitment or line of credit from another lender that is senior to the credit union's lien position, divided by the current collateral value. The current collateral value shall be established by prudent and accepted commercial lending practices and shall comply with all regulatory requirements. For a construction and development loan, collateral value is the lesser of the cost to complete or the prospective market value, as determined in accordance with s. DFI-CU 72.03.

(14)(a) "Member business loan" means any of the following:

1. A commercial loan as defined in sub. (3).
2. Any loan secured by a vehicle manufactured for household use that will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose, if the outstanding aggregate net member business loan balance is \$50,000 or greater.

(b) "Member business loan" does not include any of the following:

1. A loan for which a federal or state agency fully insures repayment, fully guarantees repayment or provides an advance commitment to purchase the loan in full.
2. Any non-member commercial loan or non-member participation interest in a commercial loan made by another lender, provided the credit union acquired these interests, and the credit union is not, in conjunction with another credit union, trading member business loans to circumvent the aggregate limit.
3. Any loan that is fully secured by a lien on a one- to four- family dwelling.

(15) "NCUA" means the National Credit Union Administration.

(16) "Net worth" has the meaning given in s. 12 CFR 702.2(f).

(17) "Readily marketable collateral" means a financial instrument or bullion that is salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market.

(18)(a) "Residential property" means a manufactured home, whether completed or under construction, house, condominium unit, cooperative unit, or unimproved land zoned for one- to four- family residential use.

(b) "Residential property" does not include a boat or motor home, even if used as a primary residence, or timeshare property.

DFI-CU 72.02 Prohibited member business loans. (1) INELIGIBLE BORROWERS.
A credit union may not grant a commercial loan to any of the following:

(a) A senior management employee directly or indirectly involved in the credit union's commercial loan underwriting, servicing or collection process, and any of their immediate family members.

(b) A person meeting the definition of an associated borrower with respect to persons identified in par. (a).

(c) A director, unless the credit union's board of directors approves granting the loan and the director was recused from the board's decision making process.

(2) EQUITY AGREEMENTS AND JOINT VENTURES. A credit union may not grant a commercial loan if any additional income received by the credit union or its senior management employees is tied to the profit or sale of any business or commercial endeavor that benefits from the proceeds of the loan.

(3) CONFLICTS OF INTEREST. A third party used by a credit union to meet the requirements of this section shall be independent from the commercial loan transaction, and may not have a participation interest in a loan or an interest in any collateral securing a loan that the third party is responsible for reviewing, or an expectation of receiving compensation that is contingent on the closing of the loan, except as follows:

(a) A third party may provide a service to the credit union that is related to the transaction, including loan servicing.

(b) A third party may provide the requisite experience to a credit union and purchase a loan or a participation interest in a loan originated by the credit union that the third party reviewed.

(c) A credit union may use the services of a credit union service organization that meets the requirements of s. DFI-CU 72.04(4) even if the credit union service organization is not independent from the transaction, provided the credit union has a controlling financial interest in the credit union service organization as determined under generally accepted accounting principles.

DFI-CU 72.03 Additional requirements for construction and development loans.

(1) DEFINITIONS. In this section:

(a) "Cost to complete" means the sum of all qualifying costs necessary to complete a construction project and documented in an approved construction budget.

(b) "Prospective market value" means the market value opinion determined by an independent appraiser in a form and manner prescribed by the office of credit unions.

(c) "Prospective market value 'as-completed'" means the property's market value at the time the development is to be completed.

(d) "Prospective market value 'as-stabilized'" means the property's market value when the property is projected to achieve stabilized occupancy. For an income producing property, stabilized occupancy means the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period of time and at comparable terms and conditions to other similar properties.

(e)1. "Qualifying costs" means any of the following:

a. Reasonable and customary costs paid to construct or improve a project, and other expenses normally included in a construction contract, including on- or off-site improvements, building construction, general contractor's fees, bonding and contractor insurance.

b. The value of the land, determined as the lesser of appraised market value or purchase price plus the cost of any improvements.

c. Interest, a contingency account to fund unanticipated overruns, development costs including fees, and related pre-development expenses. Interest expense is a qualifying cost only to the extent it is included in the construction budget and is calculated based on the projected changes in the loan balance up to the expected "as-complete" date for owner-occupied non-income producing commercial real estate or the "as-stabilized" date for income producing real estate.

d. Project costs for related parties, if reasonable in comparison to the cost of similar services from a third party. Project costs for related parties includes developer fees, leasing expenses, brokerage commissions, and management fees.

2. "Qualifying costs" does not include interest or preferred returns payable to equity partners or subordinated debt holders, the developer's general corporate overhead, and selling costs to be funded out of sales proceeds. Selling costs funded out of sales proceeds include brokerage commissions and closing costs.

(2) COLLATERAL VALUATION. The collateral valuation for securing a construction or development loan shall be based on the satisfactory completion of the proposed construction or renovation where the loan proceeds are disbursed in increments as the work is completed.

(3) PROVISIONS. A credit union that elects to make a construction or development loan shall ensure that its commercial loan policy includes adequate provisions by which the collateral value associated with the project is properly determined and established. Collateral value shall be the lesser of the project's cost to complete or its prospective market value.

(4) POLICY INCLUSIONS. A credit union that elects to make a construction and development loan shall ensure that its commercial loan policy includes all of the following:

(a) A review and approval process of any line item construction budget, conducted by qualified personnel representing the interests of the credit union and completed prior to closing the loan.

(b) A requisition and loan disbursement process approved by the credit union.

(c) A process by which the release or disbursement of loan funds shall occur only after on-site inspections, documented in a written report by qualified personnel representing the interests of the credit union. The report shall certify that the work requisitioned for payment has been satisfactorily completed, and that any remaining funds available to be disbursed from the construction and development loan is sufficient to complete the project.

(d) A process by which each loan disbursement is subject to confirmation that no intervening liens have been filed.

(5) PROSPECTIVE MARKET VALUE. An opinion regarding prospective market value that complies with standards set forth in the Uniform Standards of Professional Appraisal Practice may be accepted by the office of credit unions. Prospective value opinions are intended to reflect the current expectations and perceptions of market participants, based on available data. Two prospective value opinions may be required to reflect the time frame during which development, construction and occupancy occur.

DFI-CU 72.04 Board of directors, senior executive officers and lending personnel responsibilities. (1) BOARD OF DIRECTORS. Prior to engaging in commercial lending, the board of directors of a credit union shall do all of the following:

(a) Approve a commercial loan policy that complies with s. DFI-CU 72.05. The board shall review its policy on an annual basis. The board shall update its policy prior to any material

change in the credit union's commercial lending program or related organizational structure, and in response to any material change in portfolio performance or economic conditions.

(b) Ensure the credit union appropriately staffs its commercial lending program in compliance with subs. (2) and (3).

(c) Understand and remain informed, through periodic briefings from responsible staff and other methods, about the nature and level of risk in the credit union's commercial loan portfolio, including its potential impact on the credit union's earnings and net worth.

(2) SENIOR EXECUTIVE OFFICERS. The senior executive officers overseeing the commercial lending function of a credit union engaged in commercial lending shall do all of the following:

(a) Maintain a comprehensive understanding of the role of commercial lending in the credit union's overall business model.

(b) Establish risk management processes and controls necessary to safely conduct commercial lending.

(3) LENDING PERSONNEL. A credit union engaged in commercial lending shall employ qualified staff with experience in all of the following areas:

(a) Underwriting and processing for the types of commercial lending in which the credit union is engaged.

(b) Overseeing and evaluating the performance of a commercial loan portfolio, including rating and quantifying risk through a credit risk rating system.

(c) Conducting collection and loss mitigation activities for the types of commercial lending in which the credit union is engaged.

(4) OPTIONS TO REQUIRED EXPERIENCE. (a) A credit union may meet the experience requirements in subs. (2) and (3) by conducting internal training and development, hiring qualified personnel or using a third-party. A third-party may include an independent contractor or credit union service organization.

(b) Use of a third-party under sub. (3) is permissible only if all of the following requirements are met:

1. The third-party has no affiliation or contractual relationship with the borrower or any associated borrowers.
2. The actual decision to grant a loan resides with the credit union.
3. Qualified credit union staff exercises ongoing oversight over the third party by regularly evaluating the quality of work the third party performs for the credit union.
4. The third-party arrangement complies with s. DFI- CU 72.02.

DFI-CU 72.05 Commercial and member business loan policy requirements. (1)

Prior to engaging in commercial lending, a credit union shall adopt and implement a comprehensive written commercial loan policy and establish procedures for commercial lending. The policy shall ensure that the credit union's commercial lending activities are performed in a safe and sound manner by providing for ongoing control, measurement and management of its commercial lending activities. The policy shall be approved by the board of directors of the credit union.

(2) A credit union's commercial loan policy shall address all of the following:

(a) Types of commercial loans permitted.

(b) Trade area.

(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 shall 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 credit union's net worth or \$100,000, 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 s. DFI-CU 72.01(17), unless a waiver is obtained under s. DFI-CU 72.08. Any insured or guaranteed portion of a commercial loan made through a program in which a federal or state agency insures repayment, guarantees repayment or provides an advance commitment to purchase the loan in full is excluded from this limit.

(d) Qualifications and experience requirements for personnel involved in underwriting, processing, approving, administering and collecting commercial loans.

(e) Loan approval processes, including establishing levels of loan approval authority commensurate with the proficiency of a loan committee or an individual in evaluating and understanding commercial loan risk when considered in terms of the level of risk the borrowing relationship poses to the credit union.

(f) Underwriting standards commensurate with the size, scope and complexity of the commercial lending activities and the borrowing relationships contemplated. The underwriting standards shall address all of the following:

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.

2. Thorough due diligence of every principal to determine whether any related interests of the principal 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.

3. Requirements of a projection prepared by a borrower when historic performance does not support projected debt payments. The projection shall be supported by reasonable rationale and include a projected balance sheet, and income and expense statement.

4. Financial statement quality and degree of verification sufficient to support an accurate financial analysis and risk assessment.

5. Methods to be used in collateral evaluation for all types of collateral authorized, including loan-to-value ratio limits. Methods shall be appropriate for the particular type of collateral, the means to secure various types of collateral and the measures taken for environmental due diligence.

6. Appropriate risk assessment, including analysis of the impact of current market conditions on the borrower and associated borrowers.

(g) Risk management processes commensurate with the size, scope and complexity of the credit union's commercial lending activities and borrowing relationships, including all of the following:

1. Use of loan covenants, if appropriate, including frequency of borrower and guarantor financial reporting.

2. Periodic loan review, consistent with loan covenants and sufficient to conduct portfolio risk management. The review shall include a periodic reevaluation of the value and marketability of any collateral.

3. A credit risk rating system. Credit risk ratings shall be assigned to commercial loans at inception and reviewed as frequently as necessary to satisfy the credit union's risk monitoring

and reporting policies, and to ensure adequate reserves as required by generally accepted accounting principles.

4. A process to identify, report and monitor loans approved as exceptions to the credit union's loan policy.

DFI-CU 72.06 Collateral and security requirements. (1) A credit union shall require collateral commensurate with the level of risk associated with the size and type of any commercial loan. Collateral shall be sufficient to ensure adequate loan balance protection along with appropriate risk sharing with the borrower and principals. A credit union making an unsecured loan shall determine and document in the loan file any mitigating factors that sufficiently offset the relevant risk.

(2) A credit union that does not require the full and unconditional personal guarantee from the principals of a borrower who has a controlling interest in the borrower shall determine and document in the loan file any mitigating factors that sufficiently offset the relevant risk.

DFI-CU 72.07 Calculating the aggregate 15 percent limit. For the purpose of calculating the aggregate 15 percent limit, the credit union shall do all of the following:

(1) Calculate the numerator by adding together the amount of the commercial loans to a borrower and associated borrowers, if any. From the total, subtract any portion that is any of the following:

- (a) Secured by shares in the credit union.
- (b) Secured by shares or deposits in other financial institutions.
- (c) Insured or guaranteed by a federal or state agency.
- (d) Subject to an advance commitment to purchase by a federal or state agency.

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

DFI-CU 72.08 Waivers. (1) A credit union may seek a waiver for the maximum loan amount to borrowers and associated borrowers under s. DFI-CU 72.05.

(2) To obtain a waiver, a credit union shall submit a written request to the director. The request shall contain all of the following:

- (a) A copy of the current commercial and member business loan policy.
- (b) The higher limit sought and an explanation of the need for the increase.
- (c) Documentation supporting the member's ability to repay the loan. Supporting documentation includes cash flow analysis and collateral requirements, loan presentation and details, and the credit union's review and approval of the plan.
- (d) Documentation supporting the credit union's ability to manage the loan. Supporting documentation includes an analysis of the credit union's experience and qualifications in making related types of loans, and loan procedures including monitoring, servicing and collection.

(3) 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, liquidity, and sensitivity to market risk, CAMELS, composite and component ratings.

(4) The director shall notify the credit union of the action taken within 45 calendar days of receiving a completed request for waiver.

(5) If the request for waiver is approved, the director shall promptly notify the applicable region of the NCUA of the approval.

DFI-CU 72.09 Limit on aggregate member business lending, exemptions and method of calculation. (1) **LIMITS.** The aggregate limit on a credit union's net member business loan balances shall be the lesser of 1.75 times the actual net worth of the credit union, or 1.75 times the minimum net worth required under s. 12 USC 1790d(c)(1)(A).

(2) **EXEMPTIONS.** All of the following credit unions are exempt from compliance with the aggregate member business loan limit in this section:

(a) A credit union that has a low income designation under s. 12 CFR 701.34.

(b) A credit union that participates in the Community Development Financial Institutions program under s. 12 CFR 1805.201.

(c) A credit union that was chartered for the purpose of making member business loans, as supported by the credit union's charter, bylaws, business plan, field of membership, board minutes and loan portfolio.

(d) A credit union that, as of the date of enactment of the Credit Union Membership Access Act of 1998, had a history of primarily making commercial loans.

(3) **METHOD OF CALCULATION.** For the purposes of NCUA form 5300 reporting, a credit union's net member business loan balance is determined by calculating the outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is subject to any of the following:

(a) Secured by shares in the credit union.

(b) Secured by shares or deposits in other financial institutions.

(c) Secured by a lien on a member's primary residence.

(d) Insured or guaranteed by a federal or state agency

(e) Subject to an advance commitment to purchase by a federal or state agency.

(f) Sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

DFI-CU 72.10 Obtaining an exemption. (1) An exemption under s. DFI-CU 72.09(2)(a) and (b) shall be effective upon written notice from the credit union to the director of such designation or participation.

(2) To obtain an exemption under s. DFI-CU 72.09(2)(c) and (d), a credit union shall submit its request to the director. The exemption request shall include documentation demonstrating that the credit union meets the criteria for the exemption. An exemption is not effective until approved by the director. The director's decision on the request shall be promptly forwarded to the applicable region of the NCUA.

(3) Exemptions to the aggregate limit remain in effect unless revoked by the director for safety and soundness reasons.

DFI-CU 72.11 Recordkeeping requirements. A credit union shall separately identify member business loans in its records. A credit union shall identify member business loans in the aggregate in its financial reports.

DFI-CU 72.12 Transitional provisions. (1) **WAIVERS.** Any waiver previously approved by the office of credit unions regarding a credit union's aggregate member business

loan limit or maximum loan amount to a borrower and associated borrower remains in effect unless revoked by the office of credit unions. Reasons for revoking a waiver include all of the following:

- (a) Safety and soundness concerns.
- (b) Non-surviving credit union with waiver is party of a merger under s. 186.31, Stats.
- (c) Liquidation.
- (d) Violations of law.

(2) **LIMITATIONS OR CONDITIONS.** Limitations or other conditions imposed on a credit union by the office of credit unions or the NCUA remain in effect until modified by the office of credit unions or the NCUA. Limitations or conditions include directives from the office of credit unions or the NCUA, items specified in a document of resolution, letters of understanding and agreement, regional director letters, preliminary warning letters, enforcement actions, and constraints or conditions within any waiver issued by the office of credit unions.

SECTION 2. EFFECTIVE DATE. This rule shall take effect on the first day of the sixth month following publication in the Wisconsin Administrative Register as provided in s. 227.22 (2) (intro.), Stats.

ADMINISTRATIVE RULES

Fiscal Estimate & Economic Impact Analysis

1. Type of Estimate and Analysis <input checked="" type="checkbox"/> Original <input type="checkbox"/> Updated <input type="checkbox"/> Corrected	2. Date September 6, 2017
3. Administrative Rule Chapter, Title and Number (and Clearinghouse Number if applicable) DRI-CU 72, Commercial and Member Business Loans	
4. Subject Rules related to commercial and member business loans offered by state-chartered credit unions.	
5. Fund Sources Affected <input type="checkbox"/> GPR <input type="checkbox"/> FED <input checked="" type="checkbox"/> PRO <input type="checkbox"/> PRS <input type="checkbox"/> SEG <input type="checkbox"/> SEG-S	6. Chapter 20, Stats. Appropriations Affected 20.144(1)(g)
7. Fiscal Effect of Implementing the Rule <input checked="" type="checkbox"/> No Fiscal Effect <input type="checkbox"/> Increase Existing Revenues <input type="checkbox"/> Increase Costs <input type="checkbox"/> Indeterminate <input type="checkbox"/> Decrease Existing Revenues <input type="checkbox"/> Could Absorb Within Agency's Budget <input type="checkbox"/> Decrease Cost	
8. The Rule Will Impact the Following (Check All That Apply) <input type="checkbox"/> State's Economy <input checked="" type="checkbox"/> Specific Businesses/Sectors <input type="checkbox"/> Local Government Units <input type="checkbox"/> Public Utility Rate Payers <input type="checkbox"/> Small Businesses (if checked, complete Attachment A)	
9. Would Implementation and Compliance Costs Be Greater Than \$20 million? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
10. Policy Problem Addressed by the Rule The objective of the proposed rule is to revise Wisconsin's existing member business loan (MBL) rule for state-chartered credit unions to incorporate recent changes made to the federal MBL rule. In particular, the proposed changes strengthen a credit union's board of directors and management responsibilities; replace current loan-to-value requirements and portfolio limits with a risk-based approach; modify waiver requirements and processes for obtaining waivers; and calculate the member business loan cap as a multiple of net worth, and not as a percentage of assets.	
11. Summary of the businesses, business sectors, associations representing business, local governmental units, and individuals that may be affected by the proposed rule that were contacted for comments. The proposed rule was posted to the Department of Financial Institution's website for fourteen calendar days in order to solicit comments from businesses, business sectors, associations representing business, local governmental units and individuals that may be affected by the proposed rule. The Department also contacted trade associations representing businesses with interests in the MBL rule to alert the associations of the request for comment regarding the economic impact of the proposed changes to ch. DRI-CU 72. One comment was received. The comment was from the Wisconsin Credit Union League (League). A summary of the comment includes: The League believes the proposed rule will have a negative impact on state-chartered credit unions with less than \$250 million in assets because the proposed rule does not adopt an exemption for these credit unions as is provided under the federal MBL rule. In particular, the federal MBL rule provides credit unions with assets of less than \$250 million to be exempt from both board of director responsibilities and from establishing a commercial lending policy. The League believes the small credit unions would be at a commercial disadvantage as to federally-chartered credit unions and other state-chartered credit unions in states that have adopted the federal MBL rule in whole.	
12. Identify the local governmental units that participated in the development of this EIA. No local government units participated in the development of this EIA.	
13. Summary of Rule's Economic and Fiscal Impact on Specific Businesses, Business Sectors, Public Utility Rate Payers, Local Governmental Units and the State's Economy as a Whole (Include Implementation and Compliance Costs Expected to be Incurred)	

ADMINISTRATIVE RULES Fiscal Estimate & Economic Impact Analysis

Under Wisconsin's current MBL rule, before a credit union of any size can engage in MBL activity: (1) the credit union's board of directors must adopt a specific MBL policy (the policy must be reviewed at least annually); and (2) the MBL policy must include all items currently identified within s. DFI-CU 72.06. Credit unions of all size currently incur costs associated with the creation, annual review, and update of its MBL policy, as applicable. While it is anticipated that credit unions that engage in MBL lending will need to review and possibly update their current MBL policy to take advantage of the flexibilities offered under the proposed rule revisions, the Department's Office of Credit Unions believes this review will not have a significant impact on Wisconsin's state-chartered credit unions.

The Department's Office of Credit Unions also reviewed the proposed rule's impact on small credit unions. Pursuant to s. 227.114(1), Stats. a "small business" is defined to mean a business which is independently owned and operated and not dominate in its field, and which employs 25 or fewer full-time employees or which has a gross annual sales of less than \$5,000,000. While credit unions do not have gross annual sales, in the spirit of determining the economic impact of the proposed rule on small credit unions, the Department's Office of Credit Unions used "assets" in lieu of "gross annual sales" as the closest approximation to determine the effect on small businesses under s. 227.114(1), Stats. Only 27 out of the 143 Wisconsin federally-insured state-chartered credit unions fall within this definition of small business. Typically these credit unions have not and currently do not engage in the commercial lending anticipated by the proposed rule. Current ch. DFI-CU 72, and the proposed revised ch. DFI-CU 72 rule, apply to only those credit unions that engage in MBL lending.

The proposed rule will not have a significant impact on any other business sector, public utility rate payers, local government units or the Wisconsin's economy as a whole.

14. Benefits of Implementing the Rule and Alternative(s) to Implementing the Rule

The proposed rule would update definitions, strengthen credit union board of director and management responsibilities, replace current loan-to-value and portfolio limits with a risk-based approach, and modify waiver requirements and process. The proposed rule would provide regulatory relief for state-chartered credit unions.

If the rule is not revised, the state MBL rule does not provide state-chartered credit unions the same flexibility as federally-chartered credit unions will have under the federal MBL rule. If the rule is not revised, some state-chartered credit unions may seek to change charter to become federally-chartered so as to be governed by the federal MBL rule rather than by ch. DFI-CU 72.

15. Long Range Implications of Implementing the Rule

The long range implications are to keep Wisconsin's MBL rules consistent where possible with federal MBL rules so as to provide parity between federal- and state-chartered credit unions. This allows Wisconsin's state-chartered credit unions to remain competitive with the products offered by federally-chartered credit unions.

16. Compare With Approaches Being Used by Federal Government

The National Credit Union Administration (NCUA) regulates federally-chartered credit unions. NCUA's commercial and member business loan (MBL) rule may be found at 12 C.F.R. Part 723. NCUA made revisions to its rule which became effective January 1, 2017. The proposed rule would update Wisconsin's rules to reflect nearly all of the recent revisions NCUA made to its MBL rule.

17. Compare With Approaches Being Used by Neighboring States (Illinois, Iowa, Michigan and Minnesota)

Illinois has a comparable rule as found at Ill. Admin Code title 38, s. 190.165. This rule gives Illinois state-chartered credit unions the authority to make member business loans (MBL). Illinois has recently adopted a rule to revise its MBL rule to reflect the recent changes in 12 C.F.R. 723. Iowa, Michigan and Minnesota follow revised 12 C.F.R. Part 723 and have not adopted a comparable state specific rule.

18. Contact Name

19. Contact Phone Number

STATE OF WISCONSIN
DEPARTMENT OF ADMINISTRATION
DOA-2049 (R09/2018)

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ADMINISTRATIVE RULES
Fiscal Estimate & Economic Impact Analysis

Kim Santos, Director, Office of Credit Union

608/267-2608

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ADMINISTRATIVE RULES
Fiscal Estimate & Economic Impact Analysis

ATTACHMENT A

1. Summary of Rule's Economic and Fiscal Impact on Small Businesses (Separately for each Small Business Sector, include Implementation and Compliance Costs Expected to be Incurred)

2. Summary of the data sources used to measure the Rule's impact on Small Businesses

3. Did the agency consider the following methods to reduce the impact of the Rule on Small Businesses?

- Less Stringent Compliance or Reporting Requirements
 - Less Stringent Schedules or Deadlines for Compliance or Reporting
 - Consolidation or Simplification of Reporting Requirements
 - Establishment of performance standards in lieu of Design or Operational Standards
 - Exemption of Small Businesses from some or all requirements
 - Other, describe:
-

4. Describe the methods incorporated into the Rule that will reduce its impact on Small Businesses

5. Describe the Rule's Enforcement Provisions

6. Did the Agency prepare a Cost Benefit Analysis (if Yes, attach to form)

- Yes No
-