A Closer Look at the MBL Guidance: Section 723.4 - Commercial Loan Policies

Now that the new MBL rule is in effect, credit unions needs to ensure that they are in compliance and fully understand all of the new requirements. The lengthy guidance that NCUA published in December as part of its online examiner's guide provides more detail about the rule and sheds some light on examiner expectations. Earlier this month we took a closer look at the Board and Management responsibilities in section 723.3 (available here in case you missed it). In this week's installment, we will take a deeper dive into the commercial loan policy guidance in 723.4.

Section 723.4 has been of particular concern for credit unions, as it requires all credit union to adopt and implement a board-approved commercial loan policy and establish detailed commercial lending procedures. At minimum, credit union commercial loan policies must address the following:

- Types of commercial loans permitted
- Trade area
- Portfolio concentration limits
- Single borrower limits
- Qualifications/experience requirements for lending staff
- Loan approval process
- Underwriting standards
- Risk management processes

The guidance also goes into great detail regarding the expectations for underwriting standards. The commercial loan policy should address the financial analysis and depth of review to support he credit decision. The policy should address a credit union's borrower analysis, due diligence requirements to evaluate the borrower's ability to service the debt, requirements for financial projections, the quality of the financial information or statements used to make the credit decision (using the level of assurance provided by a preparer and the required professional standards supporting the preparer's opinion), and the type of collateral allowed, LTV limits, personal guarantees and methods used for valuing the types of collateral.

Credit unions must also establish policies and procedures to identify and manage risk. At minimum, such policies should address:

- Use of loan covenants;
- Requirements for periodic loan relationship review;
- A credit risk rating system; and
- The tracking and reporting of any exceptions to the policy

Credit unions are also required to develop a formal credit risk rating system to identify and assign a credit risk rating to each commercial loan in the portfolio. It is important to note that this is not a one size fits all approach; the scope and scale of a credit risk rating system will depend on the variety of product types and the complexity of the commercial loan portfolio. CUs must assign a credit risk rating at loan inception and review ratings as often as necessary. The criteria used to assign each rating should be risk sensitive, suitable for the types of loans underwritten, and should produce a consistent and repeatable assessment of risk, and the system should have an adequate number of ratings to differentiate the varying levels of risk. The guidance also notes that more complex portfolios may benefit from a dual rating system, which is explained in greater detail in the guidance.

Stay tuned for future blog posts on the MBL guidance, and in the meantime be sure to check out NCUA's online examiner's guide, available here