

forth in § 723.20. The seven states that have already received an exemption from the Board will now have three options after the effective date of this rulemaking: (1) State supervisors may rescind their current MBL rules and require their charters to comply with NCUA's new rule; (2) they may maintain their rules as the Board had approved them; or (3) they may seek approval from the Board to adopt any variances from those rules the Board previously approved, in accordance with the process outlined in § 723.20. Commenters asked that the Board adopt a process for NCUA staff approval for any of the seven states that want to update their rules to the new NCUA rule. As noted in the 1999 final rule's preamble, the Board must approve a state's rule before a FISCU is exempt from NCUA's MBL rule. 64 FR 28721, 28728, May 27, 1999. The Board, therefore, is responsible for reviewing any state rule amendments to make a determination as to whether the state regulation, as a whole, minimizes the risk and accomplishes the overall objectives of NCUA's rule. The Board's intent is that any revisions to exempted state rules that simply update those rules to parallel changes in NCUA's rule will be approved on an expedited basis.

*Section 702.106, Standard Risk-Based Net Worth Component for MBLs*

The final rule expands the standard risk-based net worth (RBNW) component for MBLs to three tiers, from the current two. The bottom tier is risk-weighted at 6% and consists of the amount of MBLs less than or equal to 15% of total assets. The middle tier is risk-weighted at 8% and consists of the amount of MBLs greater than 15%, but less than or equal to 25%, of total assets. The top tier is risk-weighted at 14% and consists of the amount of MBLs in excess of 25% of total assets.

Twenty-six commenters stated the expansion of the standard PCA RBNW component dividing the portfolio of MBLs into three tiers is justified by the consistently low loss history of MBLs since 1998 as well as their unique characteristics. Commenters stated the proposal is a reasonable way to protect the safety and soundness of a credit union and accurately reflects the true underlying risk of MBLs. Several of these commenters noted that this measure offers appropriate relief with regard to RBNW requirements. First, they noted that, those credit unions that were chartered primarily to extend business loans or that have history of primarily extending business loans will benefit from the 3-tiered risk weights by assisting such credit unions in

managing the business loan portfolio and RBNW. Additionally, they stated purchased participations will be subject to PCA. Credit unions that plan to engage in significant participation activity will benefit from the new risk portfolios and may better manage participations and maintain adequate net worth. Fifty-two commenters stated the change is not useful as it could be because it overstates the risk. They offered alternatives to the proposed standards. The Board disagrees that the proposal overstates risks and incorporates the rationale articulated in the proposed rule's preamble regarding the appropriateness of the final rule's standard RBNW component into this rulemaking. 68 FR 16450, 16453, Apr. 4, 2003.

Five commenters stated that NCUA should allow for further risk reduction under PCA for MBLs that provide balloon or call provisions under which a loan matures within five years. They also asked that NCUA permit credit unions to include loans with five years or less in maturity in the lowest risk-weighted tier when calculating PCA. The suggestions of these commenters fail to take into account the credit risk of MBLs as well as their interest rate risk; regardless of a loan's maturity, credit risk still exists. The final rule, therefore, retains the provisions the Board proposed.

One commenter noted that the NMBL definition may cause some confusion for credit unions when calculating the standard RBNW requirement under § 702.106(b) because the PCA rule requires risk-weighting of "member business loans outstanding." For purposes of Part 702, when a credit union classifies a loan as an MBL under Part 723 at the time it makes or purchases a loan or participation interest, that loan remains an MBL for calculating the RBNW requirement until the loan is paid off. This is another issue that the Board will clarify in its future amendments to the Form 5300 call report.

*CUSO Business Loan Origination, Section 712.5*

The final rule adds business loan origination to the CUSO regulation's list of permissible activities in paragraph (c) of § 712.5.

Seventy-five commenters supported the amendment to the CUSO rule. Many of these commenters stated that by authorizing CUSOs to originate business loans, credit unions will be able to benefit from economies of scale by pooling their investments in a business lending CUSO, thus permitting them to offer MBLs to members that may

otherwise be unavailable through the credit union or other lenders. Eight bank commenters opposed the proposal and stated NCUA should reject it because it circumvents the statutory aggregate MBL limit placed on credit unions.

Four commenters asked that the final rule elaborate on the word "originate." They stated it is arguably appropriate that a CUSO conduct functions such as taking business loans applications, conducting analysis, preparing documentation, arranging for title searches or similar services, loan servicing, and review and related services. They also stated that it may also be appropriate for a CUSO to fund loans. Accordingly, they asked that the Board define the term "originate" to establish what activity is permissible through a CUSO. The final rule allows CUSOs to make business purpose loans, just as CUSOs are permitted to engage in consumer mortgage loan origination, meaning to fund or make consumer mortgage loans under § 712.5(d). This is separate from the already recognized authority of CUSOs to engage in loan support services that include loan processing and servicing under § 712.5(j).

The U.S. Treasury Department stated in its comment that it did not object to allowing CUSO business loan origination in itself but expressed concern that the proposed rule excluded participation interests in CUSO-originated MBLs purchased by credit unions from counting towards the MBL cap. As detailed in the discussion regarding § 723.16 above, the final rule does not permit a credit union to exclude any participation interest it has purchased in a loan made to one of the credit union's members. This includes loan participations originated by a CUSO.

Four commenters noted that a revision to the loan participation rule, 12 CFR 701.22, was necessary to make it clear that FCUs may purchase MBL participations from their CUSOs. On June 26, 2003, the Board proposed an amendment to § 701.22(a)(4) which will clarify that CUSOs, as credit union organizations, are eligible organizations in which credit unions may enter into participation agreements. 68 FR 39866, Jul. 3, 2003. FISCUs are subject to applicable state law on this issue.

Two commenters asked the Board to clarify that CUSOs are not subject to the MBL limitations in Part 723. These commenters are correct in that CUSOs are not required to comply with the various requirements and limitations in Part 723 when originating business loans. The Board reminds FCUs that, when entering into eligible obligation or