

CHAPTER 13-03-06

CREDIT UNION RESERVE FUNDS AND PROMPT CORRECTIVE ACTION

Section

13-03-06-01	Definitions
13-03-06-02	Maintaining an Allowance for Loan and Lease Loss Account
13-03-06-03	Calculation
13-03-06-04	Prompt Corrective Action
13-03-06-05	Requirements

13-03-06-01. Definitions.

1. "Commercial loan" means any loan, line of credit, or letter of credit, including any unfunded commitments, and any interest a credit union obtains in such loans made by another lender, to individuals, sole proprietorships, partnerships, corporations, or other business enterprises for commercial, industrial, agricultural, or professional purposes, but not for personal expenditure purposes. Excluded from this definition are loans made by a corporate credit union; loans made by a credit union to another credit union; loans made by a federally insured credit union to a credit union service organization; loans secured by a one-to-four family residential property, unless meeting the definition of an improved property loan; loans fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions; loans secured by a vehicle manufactured for household use; and loans that would otherwise meet the definition of commercial loan and which, when the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union to a borrower or an associated borrower, are equal to less than fifty thousand dollars.
2. "Credit grading system" means the same as credit risk rating system.
3. "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.
4. "Improved property loan" means an extension of credit secured by one of the following types of real property:
 - a. Farmland, ranchland, or timberland committed to ongoing management and agricultural production;
 - b. One-to-four family residential property that is not owner-occupied;
 - c. Residential property containing five or more individual dwelling units;
 - d. Completed commercial property; or
 - e. Other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied one-to-four family residential property.
5. "Net worth" means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles. Retained earnings consist of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities. Net worth does not include the allowance for loan and lease loss account or other comprehensive income/loss account. Additionally:

- a. For low income-designated credit unions, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders, and the national credit union share insurance fund;
 - b. For a credit union that acquires another credit union in a mutual combination, net worth includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, less any bargain purchase gain recognized in either case to the extent the difference between the two is greater than zero; the acquired retained earnings must be determined at the point of acquisition under generally accepted accounting principles; and a mutual combination is a transaction in which a credit union acquires another credit union or acquires an integrated set of activities and assets that is capable of being conducted and managed as a credit union; and
 - c. The term "net worth" also includes loans to and accounts in an insured credit union established under section 208 of the Federal Credit Union Act (73 Stat. 628, 84 Stat. 944, 12 U.S.C. 1788), provided such loans and accounts:
 - (1) Have a remaining maturity of more than five years;
 - (2) Are subordinate to all other claims including those of shareholders, creditors, and the national credit union share insurance fund;
 - (3) Are not pledged as security on a loan to, or other obligation of, any party;
 - (4) Are not insured by the national credit union share insurance fund;
 - (5) Have noncumulative dividends;
 - (6) Are transferable; and
 - (7) Are available to cover operating losses realized by the insured credit union that exceed its available retained earnings.
6. "Net worth ratio" means the ratio of net worth of the credit union to the total assets of the credit union.
 7. "Net worth restoration plan" means a plan submitted by the credit union and approved by the commissioner outlining the actions the credit union will take and time frames for improving the credit union's capital position and becoming well-capitalized. The plan must comply with part 702 of the national credit union administration's rules and regulations.
 8. "Quarterly reserve requirement" means a transfer from current quarter earnings into the regular reserve account equal to one-tenth of one percent of assets.
 9. "Risk-based net worth requirement" means the level of net worth necessary given the risk level of the credit union as defined in part 702 of the national credit union administration's rules and regulations.
 10. "Total assets" means quarter end asset balance, average daily balance over the calendar quarter, average month-end balances over the three calendar months in the calendar quarter, or the average of quarter end balances of the current and preceding calendar quarters.
 11. "Total reserves" means, for the purpose of this chapter, the sum of the following:
 - a. The retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles;
 - b. The allowance for loan and lease loss account;

- c. Other comprehensive income or loss;
 - d. Unrealized gain or loss on available for sale securities; and
 - e. Secondary capital.
12. "Retained earnings" means undivided earnings, regular reserves, and any other appropriations designated by regulatory authorities.

History: Amended effective January 1, 1981; August 1, 1984; June 1, 2002; January 1, 2007; January 1, 2013; January 1, 2019.

General Authority: NDCC 6-01-04

Law Implemented: NDCC 6-06-08.4, 6-06-21

13-03-06-02. Maintaining an allowance for loan and lease loss account.

All credit unions operating under a charter issued by the state of North Dakota shall be required to maintain an allowance for loan and lease loss account in accordance with generally accepted accounting principles and rules of the national credit union administration.

History: Amended effective June 1, 1979; January 1, 1981; January 1, 2007; January 1, 2013; January 1, 2019.

General Authority: NDCC 6-01-04

Law Implemented: NDCC 6-06-08.4, 6-06-21

13-03-06-03. Calculation.

The adequacy of the allowance for loan and lease loss account as required under North Dakota Century Code section 6-06-21 will be based upon generally accepted accounting principles and incorporate the credit union's credit risk rating system as outlined in section 13-03-06-05. The commissioner may require a credit union to put aside additional reserves when funding levels are deemed to be unsafe or unsound as set forth in North Dakota Century Code section 6-06-08.4.

History: Effective January 1, 1981; amended effective June 1, 2002; January 1, 2007; January 1, 2013; January 1, 2019.

General Authority: NDCC 6-01-04

Law Implemented: NDCC 6-06-08.4, 6-06-21

13-03-06-04. Prompt corrective action.

When the credit union's net worth ratio falls below seven percent after allowing for full and fair disclosure in the allowance for loan and lease loss account, or fails to meet the risk-based net worth requirements of part 702 of the national credit union administration's rules and regulations, the credit union is required to meet the prompt corrective action requirements under North Dakota Century Code section 6-06-08.4 and part 702 of the national credit union administration's rules and regulations. Any required reserves to be made under prompt corrective action will be made to the regular reserve account.

History: Effective January 1, 1981; amended effective May 1, 1981; January 1, 2007; January 1, 2013; January 1, 2019.

General Authority: NDCC 6-01-04

Law Implemented: NDCC 6-06-08.4, 6-06-21

13-03-06-05. Requirements.

The board of directors shall develop a policy requiring risk monitoring and a credit grading system, and management shall establish a process to implement a credit grading system and monitoring to effectively measure and monitor the level of risk in relation to total reserves. The system must:

1. Assign credit risk ratings to commercial loans at inception and reviewed as frequently as necessary to satisfy the credit union's risk monitoring and reporting policies;
2. Ensure adequate allowance for loan and lease loss funding as required by generally accepted accounting principles;
3. Include the loan classification categories of watch or special mention, substandard, doubtful, and loss;
4. Accurately identify loan risk ratings and classifications in accordance with accepted industry and regulatory guidance and as assigned during examinations;
5. Establish a process for the board of directors to oversee the performance of the loan portfolio, including periodic reporting to the board of directors aggregate loan portfolio credit risk rating levels, trends, loan classifications as a percentage of the credit union's total reserves or net worth, and loan concentration levels to net worth in relation to established policy limits;
6. Include board of director review of the need for independent review and validation of the accuracy of the commercial loan credit risk rating system and frequency of such action; and
7. Assess the impact of current market conditions and the potential impact of changing market conditions in a stressed environment to include:
 - a. For commercial loans, the impact of the changes on the borrower, associated borrowers, and credit union's earnings and net worth;
 - b. Portfolio concentrations greater than one hundred percent of credit union net worth in consumer loans with similar characteristics, assess the impact of changes on credit union's earnings and net worth; and
 - c. Portfolio concentrations greater than one hundred percent of credit union net worth in investments with similar characteristics, assess the impact of changes on credit union's earnings and net worth.

History: Effective January 1, 2019.

General Authority: NDCC 6-01-04

Law Implemented: NDCC 6-06-06