NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 6**

NCUA 8006 (M3500) DATE: December 2003

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 6 to the National Credit Union Administration Rules and Regulations (Revised November 2001)

1. PURPOSE. To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.21—Loans to Members and Lines of Credit to Members. Revised paragraph (c)(7)(ii)(C).

   b. **Part 702—Prompt Corrective Action.**

   § 702.106—Standard calculation of risk based net worth requirement.

   — *Member business loans outstanding.* Revised paragraph (b).

   — Table 4—Standard Calculation of RBNW Requirement. Revised calculations for line (b) MBLs outstanding.

   Appendices to Subpart A

   — Appendix A—Example Standard Components for RBNW Requirement, § 702.106 (Example Calculation in Bold). Revised the calculations for line (b) MBLs outstanding.

   — Appendix D—Example of Member Business Loans Alternative Component, § 702.107(b) (Example Calculation in Bold). Revised the calculations for the Variable-rate MBLs maturity for 0 to 3 years.

   — Appendix H—Example RBNW Requirement Using Alternative Components (Example Calculation in Bold). Revised the calculations for line "(b) MBLs outstanding"; line "(e) Average-risk assets"; and "RBNW requirement*" in the Standard component column.

c. **Part 704—Corporate Credit Unions.**

§ 704.7—Lending. Revised paragraph (e)(2).

§ 704.11—Corporate Credit Union Service Organizations (Corporate CUSOs).

— Removed paragraph (b)(4).

— Revised the letter (l) to the letter (j) in paragraph (c).

d. **Part 712—Credit Union Service Organizations (CUSOs).**

§ 712.5—What activities and services are preapproved by CUSOs? Redesignated paragraphs (c) to (q) as paragraphs (d) to (r) and added new paragraph (c).

e. **Part 723—Member Business Loans.**

§ 723.1—What is a member business loan? Added the phrase "the net member business loan balances are" after the word "when" in paragraph (b)(3); added paragraphs (c), (d), and (e).

§ 723.3—What are the requirements for construction and development lending? Revised paragraphs (a) and (b).

§ 723.5—How do you implement a member business loan program? Revised by adding new paragraphs (a) and (b).

§ 723.6—What must your member business loan policy address?

— Added the phrase "secured and unsecured" before the word "business" in paragraph (c).

— Added "§ 723.7(c)(2) and" after the words "subject to" in paragraph (e).

— Added a phrase after the word "loan" in paragraph (g).

— Removed paragraphs (h) and (i); redesignated paragraphs (j) to (m) as paragraphs (h) to (k).

§ 723.7—What are the collateral and security requirements? Revised the entire section.

§ 723.8—How much may one member or a group of associated members borrow? Revised introductory paragraph and paragraphs (a) and (b).

§ 723.9—How do you calculate the aggregate 15% limit? Removed and reserved.

§ 723.10—What waivers are available? Revised the entire section.

§ 723.14—How do I classify loans to as to reserve for potential losses? Removed and reserved.

§ 723.15—How much must I reserve for potential losses? Removed and reserved.

§ 723.16—What is the aggregate member business loan limit for a credit union? Revised the entire section.

§ 723.21—Definitions. Added a new definition.

f. **Part 742—Regulatory Flexibility Program.**

§ 742.4—From what NCUA regulations will I be exempt? Removed the words "§ 703.12(c); and § 703.16(b) of this chapter" and replaced with "§ 703.12(c), § 703.16(b), and § 723.7(b) of this chapter" in paragraph (a).

g. **Part 792—Requests for Information Under the Freedom of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information.**

§ 792.07—Where do I send my request? Revised paragraphs (a) through (c).

§ 792.08—What must I include in my request? Revised paragraph (a).

§ 792.10—What will NCUA do with my request? Added paragraph (f).

§ 792.14—Who is responsible for responding to my request? Revised the first sentence and added a sentence after the first sentence.

§ 792.28—What if I am not satisfied with the response I receive? Revised the third sentence of the introductory paragraph.

2. This change also corrects typographical errors and formatting problems found in other parts of the manual.

3. INSTRUCTIONS:

Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
701–5 thru 701–6	701–5 thru 701–6
702–5 thru 702–8	702–5 thru 702–8
702–11 thru 702–14	702–11 thru 702–14
704–9 thru 704–10	704–9 thru 704–10
704–13 thru 704–14	704–13 thru 704–14
712–1 thru 712–4	712–1 thru 712–4
723–1 thru 723–6	723–1 thru 723–6
742–1 thru 742–2	742–1 thru 742–2
792–1 thru 792–4	792–1 thru 792–4
792–7 thru 792–8	792–7 thru 792–8

4. PREAMBLES. Enclosed with Change 6 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 5**

NCUA 8006 (M3500) DATE: August 2003

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 5 to the National Credit Union Administration Rules and Regulations (Revised November 2001)

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.1—Federal credit union chartering, field of membership modifications, and conversions. Revised first paragraph.

   § 701.19—Benefits for Employees of Federal credit unions. Revised section heading and paragraphs (a) and (b). Added paragraphs (c) through (f).

   b. **Part 703—Investment and Deposit Activities.**

   Revised the entire part.

   c. **Part 709—Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation**

   § 709.13—Treatment of swap agreements in liquidation or conservatorship. New section added.

   d. **Part 740—Accuracy of Advertising and Notice of Insured Status.**

   Revised the heading and contents.

   e. **Part 741—Requirements for Insurance.**

   § 741.11—Foreign branching. New section added.

   f. **Part 742—Regulatory Flexibility Program.**

   § 742.4—From what NCUA regulations will I be exempt? Revised to include new paragraphs (a) and (b).

g. **Part 748—Security Program, Report of Crime and Catastrophic Act and Bank Secrecy Act Compliance.**

§ 748.2—Procedures for monitoring Bank Secrecy Act (BSA) compliance. Revised the section heading and paragraph (b).

h. **Part 791—Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observation of NCUA Board Meetings.**

§ 791.8—Promulgation of NCUA rules and regulations. Revised paragraph (a).

2. **INSTRUCTIONS:**

Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xiv	i–xv
701–1 thru 701–20	701–1 thru 701–20
703–1 thru 703–8	703–1 thru 703–10
709–7 thru 709–8	709–7 thru 709–8
740–1 thru 740–3	740–1 thru 740–3
741–5 thru 741–8	741–5 thru 741–9
742–1 thru 742–2	742–1 thru 742–2
748–1 thru 748–2	748–1 thru 748–2
791–1 thru 791–2	791–1 thru 791–2

3. **INSTRUCTIONS:** Enclosed with Change 5 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes. The preamble to § 701.1 is not enclosed. It will be sent under separate cover with the new edition of the *Chartering and Field of Membership Manual,* IRPS 03–1.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 4**

NCUA 8006 (M3500) DATE: January 2003

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 4 to the National Credit Union Administration Rules and Regulations (Revised November 2001)

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 702—Prompt Corrective Action**

   § 702.2—Definitions. Amended by redesignating current paragraphs (i) through (k) as new paragraphs (j) through (l). Added new paragraph (i) and revised newly designated paragraphs (k)(1)(i) and (k)(1)(iv). Removed the cross-reference to "paragraph (j)(1)" from newly designated paragraph (k)(2), and added cross-reference "paragraph (k)(1)."

   § 702.101—Measures and effective date of net worth classification. Amended by adding a heading to paragraph (b)(1); revised paragraph (b)(2); added a heading to paragraph (b)(3); and revised the heading of paragraph (c) and paragraph (c)(1).

   § 702.102—Statutory net worth categories. Revised Table 1 immediately preceding paragraph (b).

   § 702.103—Applicability of risk-based net worth requirement. Removed the heading "(a) Criteria" from paragraph (a); removed paragraph (b); and redesignated current paragraph (a) as the sectional introductory text, and paragraphs (a)(1) and (a)(2) as paragraphs (a) and (b), respectively.

   § 702.104—Risk portfolios defined. Removed the number "1" from the parenthetical "(Table 1)" in the introductory text and added in its place the number "2". Renumbered and redesignated other Tables throughout the part.

   § 702.105—Weighted-average life of investments. Removed the number "2" from the parenthetical "(Table 2)" in the introductory text and added the number "3". Removed the citation "§ 702.2(k)" in the introductory text and added the citation "§ 702.2(m)."

§ 702.107—Alternative components for standard calculation. Revised section (a) to the new Table 5 and added new section (d).

§ 702.108—Risk mitigation credit. Revised the section heading. Redesignated paragraphs (a) and (b) as paragraphs (b) and (c); added new paragraph (a); and revised newly designated paragraph (b).

Appendixes A-H to Subpart A of Part 702. Revised Appendix C. Redesignated Appendix F as Appendix H. Added new Appendices F and G. Revised newly designated Appendix H.

§ 702.201—Prompt corrective action for "adequately capitalized" credit unions. Revised.

§ 702.202—Prompt corrective action for "undercapitalized" credit unions. Removed the word "transfer" from the heading of paragraph (a)(1); added in its place the word "retention". Removed the words "or interest" from the heading and the text of paragraph (b)(3).

§ 702.203—Prompt corrective action for "significantly undercapitalized" credit unions. Removed the word "transfer" from paragraph (a)(1) and replaced with the word "retention". Removed the words "or interest" from the heading and the text of paragraph (b)(3).

§ 702.204—Prompt corrective action for "critically undercapitalized" credit unions. Revised the heading of paragraph (a)(1). Revised paragraph (b)(3) by removing the words "or interest" from the heading and the text. Revised paragraphs (c)(1)(iii) and (c)(4). Added new paragraph (d).

§ 702.205—Consultation with State officials on proposed prompt corrective action. Removed the words "place the credit union into conservatorship or liquidation" and added the words "take the proposed action". Removed from paragraph (c) the citation "702.201(b)".

§ 702.206—Net worth restoration plans. Revised paragraph (c)(1)(ii) and (c)(1)(iii). Added new paragraph (i).

§ 702.302—Net worth categories for new credit unions. Revised the table immediately preceding paragraph (d). Revised paragraph (d).

§ 702.303—Prompt corrective action for "adequately capitalized" new credit unions. Revised the introductory text.

§ 702.304—Prompt corrective action for "moderately capitalized," "marginally capitalized" or "minimally capitalized" new credit unions. Revised paragraphs (a)(1) through (a)(3).

§ 702.305—Prompt corrective action for "uncapitalized" new credit unions. Revised paragraphs (a), (c)(2) and added new paragraph (c)(3) and (d).

§ 702.306—Revised business plans for new credit unions. Revised paragraphs (a), (b)(2), and added new paragraph (h).

§ 702.401—Reserves. Revised paragraph (c).

§ 702.403—Payment of dividends. Revised paragraph (b).

b. **Part 703—Investment and Deposit Activities.**

§ 703.100—What investments and investment activities are permissible for me? Amended paragraph (c) by revising the second and third sentences and adding a fourth sentence.

c. **Part 704—Corporate Credit Unions.**

§ 704.2—Definitions. Revised by removing the definition of *"commercial mortgage related security", "correspondent services", "credit enhancement", "dealer bid indication", "expected maturity", "industry recognized information provider", "long term investment", "market price", "matched", "member paid-in capital", "mortgage servicing", "net interest income", "non member paid-in capital", "non secured obligation", "prepayment model", "real estate mortgage investment conduit (REMIC)", "reserve ratio", "reserves and undivided earnings", "short-term investment", and "trade association."*

§ 704.3—Corporate credit union capital. Revised paragraph (a). Redesignated paragraphs (d) through (g) as paragraphs (e) through (h); and paragraph (b) as paragraph (d). Removed paragraph (c); added paragraphs (b), (c), and (i). Revised redesignated paragraphs (e) heading, (e)(1) introductory text, (e)(2) and (e)(3)(iii) and (f). Removed the acronym "NCUA" and replaced with "the OCCU Director" in paragraphs (e)(3)(i) and (ii), (g)(2)(v) and (g)(3).

§ 704.4—Board responsibilities. Removed the word "operating" in paragraphs (a) and (b) and revised paragraph (c) introductory text.

§ 704.5—Investments. Revised paragraphs (a)(1) and (2); (c)(5), (d)(1), (e)(1), (3) and (4), (f), and (h)(2) and (3). Removed paragraphs (c)(6), (d)(3) and (d)(6). Redesignated paragraphs (d)(4) and (d)(5) as paragraphs (d)(3) and (d)(4). Revised redesignated paragraphs (d)(3) and the first sentence of (d)(4); added paragraph (h)(4); and added a semicolon after the word "and" in paragraph (c)(4).

§ 704.6—Credit risk management. Revised introductory text in paragraph (a); and revised paragraphs (a)(3), (a)(4), and (b) through (e).

§ 704.7—Lending. Removed paragraphs (c) through (g); added paragraphs (c) through (f) and redesignated paragraph (h) as paragraph (g).

§ 704.8—Asset and liability management. Removed paragraphs (a)(2), (a)(5) and (e); redesignated paragraphs (a)(3) and (a)(4) as (a)(2) and (a)(3), (a)(6) and (a)(7) as (a)(4) and (a)(5), and (f) and (g) as (e) and (f). Added "; and" at the end of redesignated paragraph (a)(5) in place of the period. Added paragraph (b)(6); revised redesignated paragraphs (a)(2), (e) and (f). Added a sentence to the end of paragraph (c); and revised paragraphs (d)(1)(i) through (iii) and (d)(2) introductory text.

§ 704.10—Investment action plan. Revised the section heading and the first sentence of paragraph (a). Replaced the acronym "NCUA" with "the OCCU Director" in paragraphs (a), (b) and (c).

§ 704.11—Corporate Credit Union Service Organizations (Corporate CUSOs). Revised paragraph (b), redesignated paragraphs (c) through (e) as paragraphs (f) through (h), added paragraphs (c), (d), and (e) and revised redesignated paragraph (g)(3).

§ 704.12—Permissible services. Revised the heading and added new paragraphs (a) through (c).

§ 704.13—Fixed assets. Removed and Reserved.

§ 704.14—Representation. Revised introductory text of paragraph (a) and redesignating paragraphs (b) through (d) as (c) through (e). Added a new paragraph (b).

§ 704.15—Audit requirements. Replaced the acronym "NCUA" with "the OCCU Director" in paragraphs (a) and (b).

§ 704.18—Fidelity bond coverage. Amended paragraph (e)(1) by removing the words "reserve ratio" and replacing the words "core capital ratio" and removing the words "reserves and undivided" and replacing with the word "retained."

§ 704.19—Wholesale corporate credit unions. Revised paragraph (b) and removed paragraph (c).

Appendix A to Part 704—Model Forms. Revised.

Appendix B to Part 704—Expanded Authorities and Requirements. Revised.

d. **Part 722—Appraisals**

§ 722.3—Appraisals required; transactions requiring a State certified or licensed appraiser. Revised the number "50,000" in paragraph (b)(2) to read "250,000."

e. **Part 741—Requirements for Insurance.**

§ 741.3 Criteria. Removed the words "Adequacy of" from the heading of paragraph (a); removed paragraph (2) and redesignated current paragraph (a)(3) as paragraph (a)(2).

f. **Part 747—Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations.**

§ **747.2005—Enforcement of orders.** Revised paragraph (b)(2).

2. This change also reflects a correction to a typographical error found on page 701–14.

3. **INSTRUCTIONS.**

   a. Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
701–13 thru 701–14	701–13 thru 701–14
702–1 thru 702–25	702–1 thru 702–26
703–3 thru 703–4	703–3 thru 703–6
704–1 thru 704–19	704–1 thru 704–20
722–3 thru 722–4	722–3 thru 722–4
741–1 thru 741–2	741–1 thru 741–2
747–39	747–39

4. **PREAMBLES.** Enclosed with Change 4 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 3**

NCUA 8006 (M3500) DATE: September 2002

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 3 to the National Credit Union Administration Rules and Regulations (Revised November 2001).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.1—Federal credit union chartering, field of membership modifications, and conversions. Revised to reflect the finalization of two interim final rules.

   b. **Part 790—Description of NCUA; Requests for Agency Action.**

   § 790.2—Central and Regional Office Organization. Revised as follows:

   (1) Removed paragraphs (b)(3), and (b)(15);

   (2) Redesignated paragraphs (b)(4) through (b)(14) as paragraphs (b)(3) through (b)(13) and paragraph (b)(16) as paragraph (b)(14);

   (3) Added one new sentence to the end of redesignated paragraphs (b)(4), (b)(8), (b)(9), and (b)(11).

   (4) Added additional wording to the last sentence of redesignated paragraph (b)(7); and

   (5) Revised redesignated paragraph (b)(13).

   c. **Part 792—Requests for Information Under the Freedom of Information Act and Privacy Act, and By Subpoena; Security Procedures for Classified Information.**

   § 792.50—Program. Replaced the words "Director of the Office of Administration, ("Director")" in paragraph (a) with "NCUA's Chief Financial Officer"; replaced the word "Director" in the second and third sentences with "Chief Financial Officer"; replaced the word "Director" in paragraph (b) with "Chief Financial Officer"; and deleted the last sentence in that same paragraph.

§ 792.51—Procedures. Replaced the words "Director or the Director's" in paragraphs (a) and (b) with "Chief Financial Officer or the Chief Financial Officer's". Replaced the word "Director" in paragraphs (a), (b) and (c) with "Chief Financial Officer." Also, in paragraph (b) replaced "Administrative Office" with "Office of the Chief Financial Officer." Replaced the words "Director and the Director's" in paragraph (c) with "Chief Financial Officer and the Chief Financial Officer's."

§ 792.54—Procedures for requests pertaining to individual records in a system of records. Replaced the words "Director of the Office of Administration" with "Privacy Act Officer, Office of General Counsel."

§ 792.69—Training and employee standards of conduct with regard to privacy. Replaced "Office of Training and Development" with "Director of the Office of Human Resources."

2. **INSTRUCTIONS:**

a. Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–ii	i–ii
xiii–xiv	xiii–xiv
701–1 thru 701–2	701–1 thru 701–2
790–1 thru 790–4	790–1 thru 790–4
792–13 thru 792–15	792–13 thru 792–15
792–20 thru 792–21	792–20 thru 792–21

3. **PREAMBLES.** Enclosed with Change 3 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET

NCUA 8006 (M3500) DATE: May 2002

CORRECTION TO CHANGE 2

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is a **correction** to Change 2 to the National Credit Union Administration Rules and Regulations (Revised November 2001).

1. **PURPOSE.** To correct errors occurring in Change 2 (April 2002) to the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.21—Loans to members and lines of credit to members. Corrected typing errors in paragraph (c)(5).

   c. **Part 741—Requirement for Insurance.**

   § 741.6—Financial and statistical and other reports. Revised paragraph (a) by removing the word "with" and replacing it with "must", and removing the words "assets in excess of $50,000,000 shall".

2. **INSTRUCTIONS:**

   Your November 2001 NCUA Rules and Regulations should be updated with corrections to Change 2 as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
701–5 thru 701–6	701–5 thru 701–6
741–5 thru 741–6	741–5 thru 741–6

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 2**

NCUA 8006 (M3500) DATE: April 2002

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 2 to the National Credit Union Administration Rules and Regulations (Revised November 2001).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.21—Loans to members and lines of credit to members. Revised paragraph (c)(7)(iii)(C).

   b. **Part 702—Prompt Corrective Action.**

   § 702.101—Measures and effective date of net worth classification. Revised paragraph (c).

   § 702.103—Applicability of risk-based net worth requirement. Revised by removing and reserving paragraph (b).

   c. **Part 741—Requirement for Insurance.**

   § 741.6—Financial and statistical and other reports. Revised paragraph (a) and removed the words "or semiannually" from paragraph (b).

2. **INSTRUCTIONS:**

a. Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–ii	i–ii
vii–viii	vii–viii
701–5 thru 701–6	701–5 thru 701–6
702–1 thru 702–4	702–1 thru 702–4
741–5 thru 741–6	741–5 thru 741–6

b. Change 1 to the NCUA Rules and Regulations dated February 2002. It has come to our attention that a few copies of Change 1 were misprinted, making it impossible to incorporate into the existing pages of your November 2001 Rules and Regulations. You may request a corrected copy of Change 1 by contacting the NCUA Distribution Center at 703–518–6340, or download Change 1 from our web site at www.ncua.gov.

3. **PREAMBLES.** Enclosed with Change 2 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 1**

NCUA 8006 (M3500) DATE: February 2002

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 1 to the National Credit Union Administration Rules and Regulations (Revised November 2001).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 700—Definitions.**

   § 700.1—Scope. Redesignated 700.1 as 700.2 (Definitions) and added a new 700.1 Scope.

   § 700.2—Definitions. Removed paragraphs (h) and (j); redesignated paragraphs (e), (f), (g), and (i), as paragraphs (g), (h), (i), and (e) respectively, and added new paragraphs (f) and (j).

   b. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.1—Federal credit union chartering, field of membership modifications, and conversions. Revised paragraph by adding "IRPS 01–3" at the end of the first sentence and changing the section reference in the second sentence from "§ 790.2(b)" to "§ 792.2(g)(1)."

   § 701.14—Change in official or senior executive officer in credit unions that are newly chartered or are in troubled condition. Revised paragraphs (b)(3)(ii) and (b)(4)(ii).

   § 701.33—Reimbursement, insurance, and indemnification of officials and employees. Revised the last sentence of paragraph (b)(2)(i).

   c. **Part 712—Credit Union Service Organizations (CUSOs).**

   § 712.2—How much can an FCU invest in or loan to CUSOs, and what parties may participate? Revised paragraph (d) and added subparagraphs (1) and (2).

   d. **Part 715—Supervisory Committee Audits and Verifications.**

   § 715.2—Definitions used in this part. Revised the first sentence of paragraph (l).

e. **Part 722—Appraisals.**

§ 722.3—Appraisals required; transactions requiring a State certified or licensed appraiser. Revised paragraph (a)(1) by replacing the number $100,000 with $250,000, and removing the words "except if it is a business loan and then the transaction value is $50,000 or less."

f. **Part 723—Member Business Loans.**

§ 723.4—What are the other applicable regulations? Revised the second sentence.

g. **Part 725—National Credit Union Administration Central Liquidity Facility.**

§ 725.2—Definitions. Revised paragraph (o).

h. **Part 742—Regulatory Flexibility Program.** This is a new part.

i. **Part 790—Description of NCUA: Requests for Agency Action.**

§ 790.2—Central and Regional Office Organization. Revised the heading of paragraph (b)(13) to read "*Office of Credit Union Development*."

j. **Part 794—Enforcement of Nondiscrimination on the Basis of Handicap in Federally Conducted Programs.** Replaced "Office of Administration" with "Office of Chief Financial Officer" located in the second paragraph of this part.

2. This change also reflects formatting corrections to Part 707 of the November 2001 revised Rules and Regulations.

3. **INSTRUCTIONS:**

a. Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
700–1	700–1
701–1 thru 701–4	701–1 thru 701–4
701–15 thru 701–16	701–15 thru 701–16
707–9 thru 707–14	707–9 thru 707–14
707–33 thru 707–59	707–33 thru 707–59
712–1 thru 712–2	712–1 thru 712–2
715–1 thru 715–2	715–1 thru 715–2
722–1 thru 722–2	722–1 thru 722–2
723–1 thru 723–2	723–1 thru 723–2
725–1 thru 725–2	725–1 thru 725–2
	742–1 thru 742–2
790–3 thru 790–4	790–3 thru 790–4
794–1	794–1
Index–1 thru Index–3	Index–1 thru Index–3

4. Enclosed with Change 1 are the Federal Register published preambles. The preambles are not part of the rules, but you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET

NCUA 8006 (M3500) Revised November 2001

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is a revision to the National Credit Union Administration Rules and Regulations.

1. **PURPOSE.** To revise the National Credit Union Administration Rules and Regulations to reflect recent final rules and to incorporate Changes 1 through 7 of the August 1998 edition. The following changes are made in this revision:

   a. **Part 701—Organization and Operation of Federal Credit Unions.**

   § 701.31—Nondiscrimination requirements. Revised paragraph (d) introductory text and paragraphs (d)(1) and (d)(2).

   b. **Part 707—Truth in Savings.**

   § 707.3—General disclosure requirements. Revised paragraph (a) and added new paragraph (g).

   § 707.4—Account disclosures. Removed paragraph (c).

   § 707.6—Periodic statement disclosures. Removed paragraph (c).

   § 707.10—Electronic communication. Added new section.

   Appendix C to Part 707—Official Staff Interpretations. Revised as follows:

   § 707.2—Definitions. Removed paragraph (t)(2)(ii) and redesignated paragraph (t)(2)(iii) as paragraph (t)(2)(ii).

   § 707.4—Account disclosures. Revised paragraph (a)(2)(i)(3) and added paragraph (a)(2)(i)(4).

   § 707.8—Advertising. Added new paragraph 9 under *(a) Misleading or Inaccurate Advertisements*; added new paragraph 4 under *(b) Permissible rates*; added new paragraph under *(e)(1) Certain media.*

§ 707.10—Requirements for electronic communication. Added new section.

a. **Part 709—Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation.**

§ 709.0—Scope. Revised the first sentence.

§ 709.12—Prepayment fees to Federal Home Loan Bank. Revised entire section.

b. **Part 712—Credit Union Service Organizations (CUSOs).**

§ 712.3—What are the characteristics of and what requirements apply to CUSO? Revised the third sentence of paragraph (a).

§ 712.5—What activities and services are preapproved for CUSOs? Revised second sentence and added a third sentence to the introductory paragraph.

§ 712.7—What must an FCU do to add activities or services that are not preapproved? Added new sentence at the end of paragraph.

c. **Part 721—Incidental Powers.** Revised entire part. Changed part heading and added new Table of Contents.

d. **Part 749—Records Preservation Program and Record Retention Appendix.** Revised entire part.

2. **CORRECTIONS.** This revision also includes corrections to typing errors found in the August 1998 version.

3. **INSTRUCTIONS.** Remove from your files the August 1998 NCUA Rules and Regulations including Changes 1 through 7 and replace with the December 2001 edition.

4. **ENCLOSURES.** The Federal Register published preambles to the recent final rules. The preambles are not part of the rules, but you may find them useful for explanatory purposes.

NCUA

Rules and Regulations

November 2001

National Credit Union Administration
Alexandria, VA 22314–3428

NCUA 8006 M3500

FOREWORD

This publication of the National Credit Union Administration Rules and Regulations dated November 2001 supersedes the August 1998 edition. All amendments and revisions to the rules and regulations that have been finalized through October 2001 have been incorporated into this edition.

Future changes to this edition will be published on a regular basis. Changes will be furnished as loose leaf pages to replace the original pages and will be numbered beginning with Change 1. These rules and regulations are officially codified in Chapter VII, Title 12 of the Code of Federal Regulations (CFR), Parts 700 through 795.

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Part 700

Definitions

§ 700.1 Scope.

The definitions in § 700.2 apply to terms used in this chapter. Many additional definitions appear in the parts where the terms are used.

§ 700.2 Definitions.

As used in this chapter:

(a) "Act" means the Federal Credit Union Act (73 Stat. 628, 84 Stat. 944, 12 U.S.C. 1751–1795(k)).

(b) "Administration" means the National Credit Union Administration.

(c) "Board" means the National Credit Union Administration Board.

(d) "Credit Union" means a credit union chartered under the Federal Credit Union Act or, as the context permits, under the laws of any State.

(e)(1) Insolvency. A credit union will be determined to be insolvent when the total amount of its shares exceeds the present cash value of its assets after providing for liabilities unless:

(i) It is determined by the Board that the facts that caused the deficient share-asset ratio no longer exist; and

(ii) The likelihood of further depreciation of the share-asset ratio is not probable; and

(iii) The return of the share-asset ratio to its normal limits within a reasonable time for the credit union concerned is probable; and

(iv) The probability of a further potential loss to the insurance fund is negligible.

(2) For purposes of this section, the following definitions are used:

(i) "Cash value of assets." Recorded value will be considered the cash value of any asset account providing accepted accounting principles and practices are followed and the provisions of law, regulation, and bylaws are met.

(ii) "Liabilities." Recorded liabilities which are due and payable, excluding shares of members and nonmembers, are considered liabilities.

(f) *Paid-in and unimpaired capital and surplus* means shares plus post-closing, undivided earnings. This does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer. "Paid-in and unimpaired capital and surplus" for purposes of the Central Liquidity Facility is defined in § 725.2(o) of this chapter.

(g) "Regional Director" means the representative of the Administration in the designated geographical area in which the office of the Federal credit union is located.

(h) "Regional Office" means the office of the Administration located in the designated geographical area in which the office of the Federal credit union is located.

(i) "State" means a State of the United States, the District of Columbia, any of the several Territories and possessions of the United States and the Commonwealth of Puerto Rico.

(j) *Unimpaired capital and surplus* means the same as "paid-in and unimpaired capital and surplus," as defined in paragraph (f) of this section.

Part 701

Organization and Operations of Federal Credit Unions

§ 701.1 Federal credit union chartering, field of membership modifications, and conversions.

National Credit Union Administration policies concerning chartering, field of membership modifications, and conversions are set forth in Interpretive Ruling and Policy Statement 03–1, Chartering and Field of Membership Policy (IRPS 03–1). Copies may be obtained by contacting NCUA at the addresses found in § 790.2(c) of this chapter.

§ 701.2 [Removed and Reserved]

§§ 701.3–701.5 [Reserved]

§ 701.6 Fees paid by Federal credit unions.

(a) *Basis for assessment.* Each calendar year or as otherwise directed by the Board, each Federal credit union shall pay to the Administration for the current National Credit Union Administration fiscal year (January 1 to December 31) an operating fee in accordance with a schedule as fixed from time to time by the National Credit Union Administration Board based on the total assets of each Federal credit union as of December 31 of the preceding year or as otherwise determined pursuant to paragraph (b) of this section.

(b) *Coverage.* The operating fee shall be paid by each Federal credit union engaged in operations as of January 1 of each calendar year, except as otherwise provided by this paragraph.

(1) *New charters.* A newly chartered Federal credit union will not pay an operating fee until the year following the first full calendar year after the date chartered.

(2) *Conversions.* A state chartered credit union that converts to Federal charter will pay an operating fee in the year following the conversion. Federal credit unions converting to state charter will not receive a refund of the operating fee paid to the Administration in the year in which the conversion takes place.

(3) *Mergers.* A continuing Federal credit union that has merged with another credit union will pay an operating fee in the following year based on the combined total assets of the merged credit union and the continuing Federal credit union as of December 31 of the year in which the merger took place. For purposes of this requirement, a purchase and assumption transaction wherein the continuing Federal credit union purchases all or essentially all of the assets of another credit union shall be deemed a merger. Federal credit unions merging with other Federal or state credit unions will not receive a refund of the operating fee paid to the Administation in the year in which the merger took place.

(4) *Liquidations.* A Federal credit union placed in liquidation will not pay any operating fee after the date of liquidation.

(c) *Notification.* Each Federal credit union shall be notified at least 30 days in advance of the schedule of fees to be paid. A Federal credit union may submit written comments to the Board for consideration regarding the existing fee schedule. Any subsequent revision to the schedule shall be provided to each Federal credit union at least 15 days before payment is due.

(d) *Assessment of Administrative Fee and Interest for Delinquent Payment.* Each Federal credit union shall pay to the Administration an administrative fee, the costs of collection, and interest on any delinquent payment of its operating fee. A payment will be considered delinquent if it is postmarked later than the date stated in the notice to the credit union provided under § 701.6(c). The National Credit Union Administration may waive or abate charges or collection of interest if circumstances warrant.

(1) The administrative fee for a delinquent payment shall be an amount fixed from time to time by the National Credit Union Administration Board and based upon the administrative costs of such delinquent payments to the Administration in the preceding year.

(2) The costs of collection shall be the actual hours expended by Administration personnel multiplied by the average hourly salary and benefits costs of such personnel as determined

by the National Credit Union Administration Board.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and Loan Rate in effect on the date when the payment is due as provided in 31 U.S.C. § 3717.

(4) If a credit union makes a combined payment of its operating fee and its share insurance deposit as provided in § 741.4 of this chapter and such payment is delinquent, only one administrative fee will be charged and interest will be charged on the total combined payment.

§§ 701.7–701.11 [Reserved]

§ 701.12 [Removed]

§ 701.13 [Removed]

§ 701.14 Change in Official or Senior Executive Officer in Credit Unions that are Newly Chartered or are in Troubled Condition.

(a) *Statement of Scope and Purpose.* Section 212 of the Federal Credit Union Act (12 U.S.C. 1790a) sets forth conditions under which a credit union must notify NCUA in writing of any proposed changes in its board of directors, committee members or senior executive staff. The regulation only applies in cases of newly chartered credit unions and credit unions in troubled condition.

(b) *Definitions.* For the purposes of this section:

(1) "Committee member" means any individual who serves as an official of the credit union in the capacity of a credit committee member or supervisory committee member.

(2) "Senior executive officer" means a credit union's chief executive officer (typically this individual holds the title of president or treasurer/manager), any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager) and the chief financial officer (controller). The term "senior executive officer" also includes employees of an entity, such as a consulting firm, hired to perform the functions of positions covered by the regulation.

(3) Except as provided in paragraph (b)(4) of this section for corporate credit unions, "troubled condition" means any insured credit union that has one or a combination of the following conditions:

(i) Has been assigned

(A) A 4 or 5 CAMEL composite rating by the NCUA in the case of a federal credit union, or

(B) An equivalent 4 or 5 CAMEL composite rating by the state supervisor in the case of a federally insured, state-chartered credit union, or

(C) A 4 or 5 CAMEL composite rating by NCUA based on core workpapers received from the state supervisor in the case of a federally insured, state-chartered credit union in a state that does not use the CAMEL system. In this case, the state supervisor will be notified in writing by the Regional Director in the Region in which the credit union is located that the credit union has been designated by NCUA as a troubled institution;

(ii) Has been granted assistance as outlined under Sections 208 or 216 of the Federal Credit Union Act.

(4) In the case of a corporate credit union, "troubled condition" means any insured corporate credit union that has one or a combination of the following conditions:

(i) Has been assigned

(A) A 4 or 5 Corporate Risk Information System (CRIS) rating by NCUA in either the Financial Risk or Risk Management composites, in the case of a federal corporate credit union, or

(B) An equivalent 4 or 5 CRIS rating in either the Financial Risk or Risk Management composites by the state supervisor in the case of a federally insured, state-chartered corporate credit union in a state that has adopted the CRIS system, or an equivalent 4 or 5 CAMEL composite rating by the state supervisor in the case of a federally insured, state-chartered corporate credit union in a state that uses the CAMEL system, or

(C) A 4 or 5 CRIS rating in either the Financial Risk or Risk Management composites by NCUA based on core workpapers received from the state supervisor in the case of a federally insured, state-chartered credit union in a state that does not use either the CRIS or CAMEL system. In this case, the state supervisor will be notified in writing by the Director of the Office of Corporate Credit Unions that the corporate credit union has been designated by NCUA as a troubled institution;

(ii) has been granted assistance as outlined under Sections 208 or 216 of the Federal Credit Union Act.

(c) *Prior Notice Requirement.* An insured credit union shall give NCUA written notice at least 30 days prior to the effective date of any addition or replacement of a member of the board of directors or committee member or the employment or change in responsibilities of any individual to a position as a senior executive officer if:

(1) The credit union has been chartered for less than 2 years; or

(2) The credit union meets the definition of troubled condition as set forth in paragraph 701.14(b)(3) or (4).

(d) *Procedures for Notice of Proposed Change in Official or Senior Executive Officer.*

(1) *Filing and acceptance.* Notices shall be filed with the appropriate Regional Director. In the case of a corporate credit union, notice shall be filed with the Director of the Office of Corporate Credit Unions. Additional references herein to Regional Director will, for corporate credit unions, mean the Director of the Office of Corporate Credit Unions. State-chartered federally insured credit unions shall also file a copy of the notice with their state supervisor. The notice shall contain information pertaining to the competence, experience, character, or integrity of the individual with respect to whom the notice is submitted, subject to the authority of the Regional Director or his or her designee to require additional information. The information submitted must include the identity, personal history, business background, and experience of the individual, including material business activities and affiliations during the past 5 years, and a description of any material pending legal or administrative proceedings in which the individual is a party and any criminal indictment or conviction of such person by a state or Federal court. Each individual on whose behalf the notice is filed must attest to the validity of the information filed. At the option of the individual, the information may be forwarded to the Regional Director by the individual; however, in such cases, the credit union must file a notice to that effect. Within ten calendar days after receiving the notice, the Regional Director will inform the credit union either that the notice is complete or that additional specified information is needed and must be submitted within 30 calendar days. If the initial notice is complete, the Regional Director will issue a written decision of approval or disapproval to the individual and the credit union within 30 calendar days of receipt of the notice. If the initial notice is not complete, the Regional Director will issue a written decision within 30 calendar days of receipt of the original notice plus the amount of time taken by the credit union to provide the requested additional information. If the additional information is not submitted within 30 calendar days of the Regional Director's request, the Regional Director may either disapprove the proposed individual or review the notice based on the information provided. If the credit union and the individual have submitted all requested information and the Regional Director has not issued a written decision within the applicable time period, the individual is approved.

(2) *Waiver of prior notice requirement.* Parties may petition the appropriate Regional Director for a waiver of the prior notice required under this Section. Waiver may be granted if it is found that delay could harm the credit union or the public interest. Any waiver shall not affect the authority of NCUA to issue a Notice of Disapproval within 30 days of the waiver, or within 30 days of any subsequent required notice.

(3) *Election of directors or credit committee members.*

(i) In the case of the election of a new member of the board of directors or credit committee member at a meeting of the members of a federally insured credit union, prior notice is not required. However, a completed notice must be filed with the appropriate Regional Director within 48 hours of the election.

(ii) If a director or credit committee member is disapproved by NCUA, the board of directors of the credit union may appoint its own alternate, to serve until the next annual meeting, contingent upon NCUA approval.

(e) *Commencement of service.* A proposed director, committee member or senior executive officer may begin to serve temporarily until the credit union and the individual are notified in writing of NCUA's approval or disapproval of the proposed addition or employment.

(f) *Notice of Disapproval.* NCUA may disapprove the individual's serving as a director, committee member or senior executive officer if it finds that the competence, experience, character, or integrity of the individual with respect to whom a notice under this section is submitted indicates that it would not be in the best interests of the members of the credit union or of the public to permit the individual to be employed by, or associated with,

the credit union. The Notice of Disapproval will advise the parties of their rights of appeal pursuant to 12 CFR Part 747 subpart J of NCUA's Regulations.

§§ 701.15–701.18 [Reserved]

§ 701.19 Benefits for Employees of Federal Credit Unions.

(a) *General authority.* A federal credit union may provide employee benefits, including retirement benefits, to its employees and officers who are compensated in conformance with the Act and the bylaws, individually or collectively with other credit unions. The kind and amount of these benefits must be reasonable given the federal credit union's size, financial condition, and the duties of the employees.

(b) *Plan trustees and custodians.* Where a federal credit union is the benefit plan trustee or custodian, the plan must be authorized and maintained in accordance with the provisions of part 724 of this chapter. Where the benefit plan trustee or custodian is a party other than a federal credit union, the benefit plan must be maintained in accordance with applicable laws governing employee benefit plans, including any applicable rules and regulations issued by the Secretary of Labor, the Secretary of the Treasury, or any other federal or state authority exercising jurisdiction over the plan.

(c) *Investment authority.* A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and part 703 or, as applicable, part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long as it has an actual or potential obligation under the employee benefit plan.

(d) *Defined benefit plans.* Under paragraph (c) of this section, a federal credit union may invest to fund a defined benefit plan if the investment meets the conditions provided in that paragraph. If a federal credit union invests to fund a defined benefit plan that is not subject to the fiduciary responsibility provisions of part 4 of the Employee Retirement Income Security Act of 1974, it should diversify its investment portfolio to minimize the risk of large losses unless it is clearly prudent not to do so under the circumstances.

(e) *Liability insurance.* No federal credit union may occupy the position of a fiduciary, as defined in the Employee Retirement Income Security Act of 1974 and the rules and regulations issued by the Secretary of Labor, unless it has obtained appropriate liability insurance as described and permitted by Section 410(b) of the Employee Retirement Income Security Act of 1974.

(f) *Definitions.* For this section, defined benefit plan has the same meaning as in 29 U.S.C. 1002(35) and employee benefit plan has the same meaning as in 29 U.S.C. 1002(3).

§ 701.20 [Reserved]

§ 701.21 Loans to Members and Lines of Credit to Members.

(a) *Statement of Scope and Purpose.* Section 701.21 complements the provisions of Section 107(5) of the Federal Credit Union Act (12 U.S.C. § 1757(5)) authorizing Federal credit unions to make loans to members and issue lines of credit (including credit cards) to members. Section 107(5) of the Act contains limitations on matters such as loan maturity, rate of interest, security, and prepayment penalties. Section 701.21 interprets and implements those provisions. In addition, Section 701.21 states the NCUA Board's intent concerning preemption of state laws, and expands the authority of Federal credit unions to enforce due-on-sale clauses in real property loans. Also, while § 701.21 generally applies to Federal credit unions only, its provisions may be used by state-chartered credit unions with respect to alternative mortgage transactions in accordance with 12 U.S.C. 3801 *et seq.,* and certain provisions apply to loans made by federally insured state-chartered credit unions as specified in § 741.203 of this chapter. Part 722 sets forth requirements for appraisals for certain real estate-secured loans made under Section 701.21 and any other applicable lending authority. Finally, it is noted that Section 701.21 does not apply to loans by Federal credit unions to other credit unions (although certain statutory limitations in Section 107 of the Act apply), nor to loans to credit union organizations (which are governed by Section 107(5)(D) of the Act and Part 712.

(b) *Relation to Other Laws:*

(1) *Preemption of state laws.* Section 701.21 is promulgated pursuant to the NCUA Board's

exclusive authority as set forth in Section 107(5) of the Federal Credit Union Act (12 U.S.C. § 1757(5)) to regulate the rates, terms of repayment and other conditions of Federal credit union loans and lines of credit (including credit cards) to members. This exercise of the Board's authority preempts any state law purporting to limit or affect:

(i) (A) rates of interest and amounts of finance charges, including:

(1) the frequency or the increments by which a variable interest rate may be changed;

(2) the index to which a variable interest rate may be tied;

(3) the manner or timing of notifying the borrower of a change in interest rate;

(4) the authority to increase the interest rate on an existing balance;

(B) late charges; and

(C) closing costs, application, origination, or other fees;

(ii) terms of repayment, including:

(A) the maturity of loans and lines of credit;

(B) the amount, uniformity, and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due;

(C) balloon payments; and

(D) prepayment limits;

(iii) conditions related to:

(A) the amount of the loan or line of credit;

(B) the purpose of the loan or line of credit;

(C) the type or amount of security and the relation of the value of the security to the amount of the loan or line of credit;

(D) eligible borrowers; and

(E) the imposition and enforcement of liens on the shares of borrowers and accommodation parties.

(2) *Matters not preempted.* Except as provided by paragraph (b)(1) of this section, it is not the Board's intent to preempt state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit, for example:

(i) insurance laws;

(ii) laws related to transfer of and security interests in real and personal property (see, however, paragraph (g)(6) of this section concerning the use and exercise of due-on-sale clauses);

(iii) conditions related to:

(A) collection costs and attorneys' fees;

(B) requirements that consumer lending documents be in "plain language"; and

(C) the circumstances in which a borrower may be declared in default and may cure default.

(3) *Other Federal law.* Except as provided by paragraph (b)(1) of this section, it is not the Board's intent to preempt state laws affecting aspects of credit transactions that are primarily regulated by Federal law other than the Federal Credit Union Act, for example, state laws concerning credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices. Applicability of state law in these instances should be determined pursuant to the preemption standards of the relevant Federal law and regulations.

(4) *Examination and Enforcement.* Except as otherwise agreed by the NCUA Board, the Board retains exclusive examination and administrative enforcement jurisdiction over Federal credit unions. Violations of Federal or applicable state laws related to the lending activities of a Federal credit union should be referred to the appropriate NCUA regional office.

(5) *Definition of State Law.* For purposes of paragraph (b) of this section, "state law" means the constitution, laws, regulations and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

(c) *General Rules—*

(1) *Scope.* The following general rules apply to all loans to members and, where indicated, all lines of credit (including credit cards) to members, except as otherwise provided in the remaining provisions of Section 701.21.

(2) *Written policies.* The board of directors of each Federal credit union shall establish written policies for loans and lines of credit consistent with the relevant provisions of the Act, NCUA's regulations, and other applicable laws and regulations.

(3) *Credit applications and overdrafts.* Consistent with policies established by the board of directors, the credit committee or loan officer shall ensure that a credit application is kept on file for each borrower supporting the decision to make a loan or establish a line of credit. A credit union may advance money to a member

to cover an account deficit without having a credit application from the borrower on file if the credit union has a written overdraft policy. The policy must: set a cap on the total dollar amount of all overdrafts the credit union will honor consistent with the credit union's ability to absorb losses; establish a time limit not to exceed forty-five calendar days for a member either to deposit funds or obtain an approved loan from the credit union to cover each overdraft; limit the dollar amount of overdrafts the credit union will honor per member; and establish the fee and interest rate, if any, the credit union will charge members for honoring overdrafts.

(4) *Maturity.* The maturity of a loan to a member may not exceed 12 years. Lines of credit are not subject to a statutory or regulatory maturity limit. Amortization of line of credit balances and the type and amount of security on any line of credit shall be as determined by contract between the Federal credit union and the member/borrower.

(5) *Ten percent limit.* No loan or line of credit advance may be made to any member if such loan or advance would cause that member to be indebted to the Federal credit union upon loans and advances made to the member in an aggregate amount exceeding 10% of the credit union's total unimpaired capital and surplus. In the case of member business loans as defined in § 723.1 of this chapter, additional limitations apply as set forth in §§ 723.8 and 723.9 of this chapter.

(6) *Early payment.* A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

(7) *Loan interest rates—*

(i) *General.* Except when a higher maximum rate is provided for in paragraph (c)(7)(ii) of this section, a Federal credit union may extend credit to its members at rates not to exceed 15 percent per year on the unpaid balance inclusive of all finance charges. Variable rates are permitted on the condition that the effective rate over the term of the loan (or line of credit) does not exceed the maximum permissible rate.

(ii) *Temporary rates.—(A) 21 percent maximum rate.* Effective from December 3, 1980 through May 14, 1987, a Federal credit union may extend credit to its members at rates not to exceed 21 percent per year on the unpaid balance inclusive of all finance charges. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear rates of interest of up to 21 percent per year after May 14, 1987.

(B) *18 percent maximum rate.* Effective May 15, 1987, a Federal credit union may extend credit to its members at rates not to exceed 18 percent per year on the unpaid balance inclusive of all finance charges.

(C) *Expiration.* After March 8, 2005, or as otherwise ordered by the NCUA Board, the maximum rate on federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with paragraph (c)(7)(ii)(A) and (B) of this section, on loans and line of credit balance existing on or before March 8, 2005.

(8)(i) Except as otherwise provided herein, no official or employee of a Federal credit union, or immediate family member of an official or employee of a Federal credit union, may receive, directly or indirectly, any commission, fee, or other compensation in connection with any loan made by the credit union.

(ii) For the purposes of this section:

Compensation includes non monetary items, except those of nominal value.

Immediate family member means a spouse or other family member living in the same household.

Loan includes line of credit.

Official means any member of the board of directors or a volunteer committee.

Person means an individual or an organization.

Senior management employee means the credit union's chief executive officer (typically, this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager), and the chief financial officer (Comptroller).

Volunteer official means an official of a credit union who does not receive compensation from the credit union solely for his or her service as an official.

(iii) This section does not prohibit:

(A) Payment, by a Federal credit union, of salary to employees;

(B) Payment, by a Federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;

(C) Payment, by a Federal credit union, of an incentive or bonus to an employee, other

than a senior management employee, in connection with a loan or loans made by the credit union, provided that the board of directors of the credit union establishes written policies and internal controls in connection with such incentive or bonus and monitors compliance with such policies and controls at least annually.

(D) Receipt of compensation from a person outside a Federal credit union by a volunteer official or non senior management employee of the credit union, or an immediate family member of a volunteer official or employee of the credit union, for a service or activity performed outside the credit union, provided that no referral has been made by the credit union or the official, employee, or family member.

(d) *Loans and Lines of Credit to Officials—*

(1) *Purpose.* Sections 107(5)(A) (iv) and (v) of the Act require the approval of the board of directors of the Federal credit union in any case where the aggregate of loans to an official and loans on which that official serves as endorser or guarantor exceeds $20,000 plus pledged shares. This paragraph implements the requirement by establishing procedures for determining whether board of directors' approval is required. The section also prohibits preferential treatment of officials.

(2) *Official.* An "official" is any member of the board of directors, credit committee or supervisory committee.

(3) *Initial approval.* All applications for loan or lines of credit on which an official will be either a direct obligor or an endorser, cosigner or guarantor shall be initially acted upon by either the board of directors, the credit committee or loan officer, as specified in the Federal credit union's bylaws.

(4) *Board of directors' review.* The board of directors shall, in any case, review and approve or deny an application on which an official is a direct obligor, or endorser, cosigner or guarantor if the following computation produces a total in excess of $20,000:

(i) Add:

(A) The amount of the current application.

(B) The outstanding balances of loans including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official.

(C) The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(ii) From the above total subtract:

(A) the amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(B) The amount of shares to be pledged by the official on the loan or line of credit applied for.

(5) *Nonpreferential treatment.* The rates, terms and conditions on any loan or line of credit either made to, or endorsed or guaranteed by

(i) an official

(ii) an immediate family member of an official, or

(iii) any individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official shall not be more favorable than the rates, terms and conditions for comparable loans or lines of credit to other credit union members. "Immediate family members" means a spouse or other family member living in the same household.

(e) *Insured, Guaranteed and Advance Commitment Loans.* A loan secured by the insurance or guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *20-Year Loans.* Notwithstanding the general 12-year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 20 years in the case of: (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board

on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one- to four-family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be executed on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal. In lieu of use of a standard security instrument and note, the Federal credit union may have a current attorney's opinion on file stating that the security instrument and note in use meet the requirements of applicable Federal, state and local laws.

(5) *First lien, territorial limits.* The loan shall be secured by a perfected first lien or first security interest in favor of the credit union supported by a properly executed and recorded security instrument. No loan shall be secured by a residence located outside the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico.

(6) *Due-on-sale clauses:*

(i) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by Section 341 of Public Law 97–320 and by any regulations issued by the Federal Home Loan Bank Board implementing Section 341.

(ii) In the case of a contract involving a long-term (greater than twelve years), fixed rate first mortgage loan which was made or assumed, including a transfer of the liened property subject to the loan, during the period beginning on the date a state adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided, the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

(A) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;

(B) the creation of a purchase money security interest for household appliances;

(C) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(D) the granting of a leasehold interest of 3 years or less not containing an option to purchase;

(E) a transfer to a relative resulting from the death of a borrower;

(F) a transfer where the spouse or children of the borrower become an owner of the property;

(G) a transfer resulting from a decree of a dissolution of marriage, a legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(H) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(I) any other transfer or disposition described in regulations promulgated by the Federal Home Loan Bank Board.

(7) *Assumption of real estate loans by nonmembers.* A federal credit union may permit a nonmember to assume a member's mortgage loan in conjunction with the nonmember's purchase of the member's principal residence, pro-

vided that the nonmember assumes only the remaining unpaid balance of the loan, the terms of the loan remain unchanged, and there is no extension of the original maturity date specified in the loan agreement with the member. An assumption is impermissible if the original loan was made with the intent of having a nonmember assume the loan.

(h) *Removed and replaced by part 723.*

(i) *Put Option Purchases in Managing Increased Interest-Rate Risk for Real Estate Loans Produced for Sale on the Secondary Market.*

(1) *Definitions.* For purposes of this § 701.21(i):

(i) "Financial options contact" means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract at any time prior to the expiration date specified in the agreement, under terms and conditions established either by (A) a contract market designated for trading such contracts by the Commodity Futures Trading Commission, or (B) by a Federal credit union and a primary dealer in Government securities that are counterparties in an over-the-counter transaction.

(ii) "FHLMC security" means obligations or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Sections 305 or 306 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. §§ 1454 and 1455).

(iii) "FNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association.

(iv) "GNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Government National Mortgage Association.

(v) "Long position" means the holding of a financial options contract with the option to make or take delivery of a financial instrument.

(vi) "Primary dealer in Government securities" means: (A) a member of the Association of Primary Dealers in United States Government Securities; or (B) any parent, subsidiary, or affiliated entity of such primary dealer where the member guarantees (to the satisfaction of the FCU's board of directors) over-the-counter sales of financial options contracts by the parent, subsidiary, or affiliated entity to a Federal credit union.

(vii) "Put" means a financial options contract which entitles the holder to sell, entirely at the holder's option, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.

(2) *Permitted Options Transactions.* A Federal credit union may, to manage risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates, enter into long put positions on GNMA, FNMA, and FHLMC securities:

(i) if the real estate loans are to be sold on the secondary market within ninety (90) days of closing;

(ii) if the positions are entered into: (A) through a contract market designated by the Commodity Futures Trading Commission for trading such contracts, or (B) with a primary dealer in Government securities;

(iii) if the positions are entered into pursuant to written policies and procedures which are approved by the Federal credit union's board of directors, and include, at a minimum: (A) the Federal credit union's strategy in using financial options contracts and its analysis of how the strategy will reduce sensitivity to changes in price or interest rates in its commitments to originate real estate loans at specified interest rates; (B) a list of brokers or other intermediaries through which positions may be entered into; (C) quantitative limits (e.g., position and stop loss limits) on the use of financial options contracts; (D) identification of the persons involved in financial options contract transactions, including a description of these persons' qualifications, duties, and limits of authority, and description of the procedures for segregating these persons' duties, (E) a requirement for written reports for review by the Federal credit union's board of directors at its monthly meetings, or by a committee appointed by the board on a monthly basis, of: (1) the type, amount, expiration date, correlation, cost of, and current or projected income or loss from each position closed since the last board review, each position currently open and current gains or losses from such positions, and each position planned to be entered into prior to the next board review; (2) compliance with limits established on the policies and procedures; and (3) the extent to which the positions described contributed to reduction of sensitivity to changes in prices or interest rates in the Federal credit union's commitments to originate real estate loans at a specified interest rate; and

(iv) if the Federal credit union has received written permission from the appropriate NCUA Regional Director to engage in financial options contracts transactions in accordance with this § 701.21(i) and its policies and procedures as written.

(3) *Recordkeeping and Reporting.*

(i) The reports described in § 701.21 (i)(2)(iii)(E) for each month must be submitted to the appropriate NCUA Regional Office by the end of the following month. This monthly reporting requirement may be waived by the appropriate NCUA Regional Director on a case-by-case basis for those Federal credit unions with a proven record of responsible use of permitted financial options contracts.

(ii) The records described in § 701.21 (i)(2)(iii)(E) must be retained for two years from the date the financial options contracts are closed.

(4) *Accounting.* A Federal credit union must account for financial options contracts transactions:

(i) in accordance with standards established by the NCUA Board in the Accounting Manual for Federal Credit Unions, available from NCUA, Administrative Office, 1775 Duke Street, Alexandria, VA 22314, or such other instruction as may be deemed appropriate; or

(ii) to the extent not inconsistent with NCUA Board instructions, in accordance with generally accepted accounting standards or principles.

§ 701.22 Loan Participation.

(a) For purposes of this section:

(1) "Participation loan" means a loan where one or more eligible organizations participates pursuant to a written agreement with the originating lender.

(2) "Eligible organizations" means a credit union, credit union organization, or financial organization.

(3) "Credit union" means any Federal or state chartered credit union.

(4) "Credit union organization" means any organization as determined by the Board, established primarily to serve the daily operational needs of its member credit unions. The term does not include trade associations, membership organizations principally composed of credit unions, or corporations or other businesses which principally provide services to credit union members as opposed to corporations or businesses whose business relates to the daily in-house operation of credit unions.

(5) "Financial organization" means any federally chartered or federally insured financial institution.

(6) "Originating lender" means the participant with which the member contracts.

(b) Subject to the provisions of this section any Federal credit union may participate in making loans with eligible organizations within the limitations of the board of directors' written participation loan policies, PROVIDED:

(1) no Federal credit union shall obtain an interest in a participation loan if the sum of that interest and any (other) indebtedness owing to the Federal credit union by the borrower exceeds 10 per centum of the Federal credit union's unimpaired capital and surplus;

(2) a written master participation agreement shall be properly executed, acted upon by the Federal credit union's board of directors, or if the board has so delegated in its policy, the investment committee or senior management offical(s) and retained in the Federal credit union's office. The master agreement shall include provisions for identifying, either through a document which is incorporated by reference into the master agreement, or directly in the master agreement, the participation loan or loans prior to their sale; and

(3) a Federal credit union may sell to or purchase from any participant the servicing of any loan in which it owns a participation interest.

(c) An originating lender which is a Federal credit union shall:

(1) originate loans only to its members;

(2) retain an interest of at least 10 per centum of the face amount of each loan;

(3) retain the original or copies of the loan documents; and

(4) Require the credit committee or loan officer to use the same underwriting standards for participation loans used for loans that are not being sold in a participation agreement unless there is a participation agreement in place prior to the disbursement of the loan. Where a participation agreement is in place prior to disbursement, either the credit union's loan policies or the participation agreement shall address any variance from non-participation loan underwriting standards.

(d) A participant Federal credit union that is not an originating lender shall:

(1) participate only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement;

(2) participate in participation loans only if made to its own members or members of another participating credit union;

(3) retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement; and

(4) obtain the approval of the board of directors or investment committee of the disbursement of proceeds to the originating lender.

§ 701.23 Purchase, Sale, and Pledge of Eligible Obligations.

(a) For purposes of this Section:

(1) "Eligible obligation" means a loan or group of loans;

(2) "Student loan" means a loan granted to finance the borrower's attendance at an institution of higher education or at a vocational school, which is secured by and on which payment of the outstanding principal and interest has been deferred in accordance with the insurance or guarantee of the Federal Government, of a State government, or any agency of either.

(b) Purchase.

(1) A Federal credit union may purchase, in whole or in part, within the limitations of the board of directors' written purchase policies:

(i) Eligible obligations of its members, from any source, if either (A) they are loans it is empowered to grant or (B) they are refinanced with the consent of the borrowers, within 60 days after they are purchased, so that they are loans it is empowered to grant;

(ii) Eligible obligations of a liquidating credit union's individual members, from the liquidating credit union;

(iii) Student loans, from any source, if the purchaser is granting student loans on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary market; and

(iv) Real estate-secured loans, from any source, if the purchaser is granting real estate secured loans pursuant to Section 701.21 on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary mortgage market. A pool must include a substantial portion of the credit union's members' loans and must be sold promptly.

(2) A Federal credit union may make purchases in accordance with this paragraph (b), provided:

(i) the board of directors or investment committee approves the purchase;

(ii) a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the purchaser's office; and for purchases under paragraph (b)(1)(ii) of this section, any advance written approval required by § 741.8 of this chapter is obtained before consummation of such purchase.

(3) The aggregate of the unpaid balance of eligible obligations purchased under paragraph (b) of this section cannot exceed 5% of the unimpaired capital and surplus of the purchaser. The following can be excluded in calculating this 5% limitation:

(i) Student loans purchased in accordance with paragraph (b)(1)(iii) of this section;

(ii) Real estate loans purchased in accordance with paragraph (b)(1)(iv) of this section;

(iii) Eligible obligations purchased in accordance with paragraph (b)(1)(i) of this section that are refinanced by the purchaser so that it is a loan it is empowered to grant; and

(iv) An indirect lending or indirect leasing arrangement that is classified as a loan and not the purchase of an eligible obligation because the federal credit union makes the final underwriting decision and the sales or lease contract is assigned to the federal credit union very soon after it is signed by the member and the dealer or leasing company.

(c) Sale.

(1) A Federal credit union may sell, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written sale policies, provided:

(i) The board of directors or investment committee approves the sale; and

(ii) A written agreement and a schedule of the eligible obligations covered by the agreement are retained in the seller's office.

(d) Pledge.

(1) A Federal credit union may pledge, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written pledge policies, provided:

(i) The board of directors or investment committee approves the pledge;

(ii) Copies of the original loan documents are retained; and

(iii) A written agreement covering the pledging arrangement is retained in the office of the credit union that pledges the eligible obligations.

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

(e) Servicing.

A Federal credit union may agree to service any eligible obligation it purchases or sells in whole or in part.

(f) 10 Percent Limitation.

The total indebtedness owing to any Federal credit union by any person, inclusive of retained and reacquired interests, shall not exceed 10 percent of its unimpaired capital and surplus.

§ 701.24 Refund of Interest.

(a) The board of directors of a Federal credit union may authorize an interest refund to members who paid interest to the credit union during any dividend period and who are members of record at the close of business on the last day of such dividend period. Interest refunds may be made for a dividend period only if dividends on share accounts have been declared and paid for that period.

(b) The amount of interest refund to each member shall be determined as a percentage of the interest paid by the member. Such percentage may vary according to the type of extension of credit and the interest rate charged.

(c) The board of directors may exclude from an interest refund: (1) a particular type of extension of credit; (2) any extension of credit made at a particular interest rate; and (3) any extension of credit that is presently delinquent or has been delinquent within the period for which the refund is being made.

§ 701.25 Charitable contributions and donations.

(a) A federal credit union may make charitable contributions and/or donate funds to recipients not organized for profit that are located in or conduct activities in a community in which the federal credit union has a place of business or to organizations that are tax exempt organizations under Section 501(c)(3) of the Internal Revenue Code and operate primarily to promote and develop credit unions.

(b) The board of directors must approve charitable contributions and/or donations, and the approval must be based on a determination by the board of directors that the contributions and/or donations are in the best interests of the federal credit union and are reasonable given the size and financial condition of the federal credit union. The board of directors, if it chooses, may establish a budget for charitable contributions and/or donations and authorize appropriate officials of the federal credit union to select recipients and disburse budgeted funds among those recipients.

§ 701.26 Credit Union Service Contracts.

A Federal credit union may act as a representative of and enter into a contractual agreement with one or more credit unions or other organizations for the purpose of sharing, utilizing, renting, leasing, purchasing, selling, and/or joint ownership of fixed assets or engaging in activities and/or services which relate to the daily operations of credit unions. Agreements must be in writing, and shall advise all parties subject to the agreement that the goods and services provided shall be subject to examination by the NCUA Board to the extent permitted by law.

§ 701.27 [Removed April 1998, replaced by new part 712]

§§ 701.28–701.29 [Reserved]

§ 701.30 [Reserved]

§ 701.31 Nondiscrimination Requirements.

(a) *Definitions:* As used in this part, the term:

(1) "application" carries the meaning of that term as defined in 12 C.F.R. 202.2(f) (Regulation B), which is as follows: "An oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested";

(2) "dwelling" carries the meaning of that term as defined in 42 U.S.C. 3602(b) (Fair

Housing Act), which is as follows: "Any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any building, structure, or portion thereof"; and

(3) "real estate-related loan" means any loan for which application is made to finance or refinance the purchase, construction, improvement, repair, or maintenance of a dwelling.

(b) *Nondiscrimination in Lending:*

(1) A Federal credit union may not deny a real estate-related loan, nor may it discriminate in setting or exercising its rights pursuant to the terms or conditions of such a loan, nor may it discourage an application for such a loan, on the basis of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With regard to a real estate-related loan, a Federal credit union may not consider a lending criterion or exercise a lending policy which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) Consideration of any of the following factors in connection with a real estate-related loan is not necessary to a Federal credit union's business, generally has a discriminatory effect, and is therefore prohibited:

(i) the age or location of the dwelling;

(ii) zip code of the applicant's current residence;

(iii) previous home ownership;

(iv) the age or location of dwellings in the neighborhood of the dwelling;

(v) the income level of residents in the neighborhood of the dwelling;

Guidelines concerning possible exceptions to this provision appear in paragraph (e)(2) of this section.

(c) *Nondiscrimination in Appraisals:*

(1) A Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With respect to a real estate-related loan, a Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of a criterion which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) A Federal credit union may not rely upon an appraisal that it knows or should know is based upon consideration of any of the following criteria, for such criteria generally have a discriminatory effect, and are not necessary to a Federal credit union's business:

(i) the age or location of the dwelling;

(ii) the age or location of dwellings in the neighborhood of the dwelling;

(iii) the income level of the residents in the neighborhood of the dwelling.

(4) Notwithstanding paragraph (c)(3) of this section, it is recognized that there may be factors concerning location of the dwelling which can be properly considered in an appraisal. If any such factor(s) is relied upon, it must be specifically documented in the appraisal, accompanied by a brief statement demonstrating the necessity of using such factor(s). Guidelines concerning the consideration of location factors appear in paragraph (e)(3) of this section.

(5) Each Federal credit union shall make available, to any requesting member/applicant,

a copy of the appraisal used in connection with that member's real estate-related loan application. The appraisal shall be available for a period of 25 months after the applicant has received notice from the Federal credit union of the action taken by the Federal credit union on the real estate-related loan application.

(d) *Nondiscrimination in advertising.* No federal credit union may engage in any form of advertising of real estate-related loans that indicates the credit union discriminates on the basis of race, color, religion, national origin, sex, handicap, or familial status in violation of the Fair Housing Act. Advertisements must not contain any words, symbols, models or other forms of communication that suggest a discriminatory preference or policy of exclusion in violation of the Fair Housing Act or the Equal Credit Opportunity Act.

(1) *Advertising notice of nondiscrimination compliance.* Any federal credit union that advertises real estate-related loans must prominently indicate in such advertisement, in a manner appropriate to the advertising medium and format used, that the credit union makes such loans without regard to race, color, religion, national origin, sex, handicap, or familial status.

(i) With respect to written and visual advertisements, a credit union may satisfy the notice requirement by including in the advertisement a copy of the logotype, with the legend "Equal Housing Lender," from the poster described in paragraph (d)(3) of this section or a copy of the logotype, with the legend "Equal Housing Opportunity," from the poster described in § 110.25(a) of the United States Department of Housing and Urban Development's (HUD) regulations (24 CFR 110.25(a)).

(ii) With respect to oral advertisements, a credit union may satisfy the notice requirement by a spoken statement that the credit union is an "Equal Housing Lender" or an "Equal Opportunity Lender."

(iii) When an oral advertisement is used in conjunction with a written or visual advertisement, the use of either of the methods specified in paragraphs (d)(1)(i) or (ii) of this section will satisfy the notice requirement.

(iv) A credit union may use any other method reasonably calculated to satisfy the notice requirement.

(2) *Lobby notice of nondiscrimination.* Every federal credit union that engages in real estate-related lending must display a notice of nondiscrimination. The notice must be placed in the public lobby of the credit union and in the public area of each office where such loans are made and must be clearly visible to the general public. The notice must incorporate either a facsimile of the logotype and language appearing in paragraph (d)(3) of this section or the logotype and language appearing at 24 CFR 110.25(a). Posters containing the logotype and language appearing in paragraph (d)(3) of this section may be obtained from the regional offices of the National Credit Union Administration.

(3) *Logotype and notice of nondiscrimination compliance.* The logotype and text of the notice required in paragraph (d)(2) of this section shall be as follows:

EQUAL HOUSING
LENDER

We Do Business in Accordance With the Federal Fair Lending Laws

UNDER THE FEDERAL FAIR HOUSING ACT, IT IS ILLEGAL, ON THE BASIS OF RACE, COLOR, NATIONAL ORIGIN, RELIGION, SEX, HANDICAP, OR FAMILIAL STATUS (HAVING CHILDREN UNDER THE AGE OF 18), TO:

- Deny a loan for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling, or deny any loan secured by a dwelling; or
- Discriminate in fixing the amount, interest rate, duration, application procedures or other terms or conditions of such a loan, or in appraising property.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

Assistant Secretary for Fair Housing and Equal Opportunity
Department of Housing & Urban Development
Washington, D.C. 20410
For processing under the Federal Fair Housing Act
and to:
National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428
For processing under NCUA Regulations

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UNDER THE EQUAL CREDIT OPPORTUNITY ACT, IT IS ILLEGAL TO DISCRIMINATE IN ANY CREDIT TRANSACTION:

- On the basis of race, color, national origin, religion, sex, marital status, or age
- Because income is from public assistance, or
- Because a right was exercised under the Consumer Credit Protection Act.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428

(e) *Guidelines:*

(1) Compliance with the Fair Housing Act is achieved when each loan applicant's creditworthiness is evaluated on an individual basis, without presuming that the applicant has certain characteristics of a group. If certain lending

policies or procedures do presume group characteristics, they may violate the Fair Housing Act, even though the characteristics are not based upon race, color, sex, national origin, religion, handicap, or familial status. Such a violation occurs when otherwise facially nondiscriminatory lending procedures (either general lending policies or specific criteria used in reviewing loan applications) have the effect of making real estate-related loans unavailable or less available on the basis of race, color, sex, national origin, religion, handicap, or familial status. Note, however, that a policy or criterion which has a discriminatory effect is not a violation of the Fair Housing Act if its use achieves a legitimate business necessity which cannot be achieved by using less discriminatory standards. It is also important to note that the Equal Credit Opportunity Act and Regulation B prohibit discrimination, either per se or in effect, on the basis of the applicant's age, marital status, receipt of public assistance, or the exercise of any rights under the Consumer Credit Protection Act.

(2) Paragraph (b)(3) of this section prohibits consideration of certain factors because of their likely discriminatory effect and because they are not necessary to make sound real estate-related loans. For purposes of clarification, the prohibited use of location factors in this section is intended to prevent abandonment of areas in which a Federal credit union's members live or want to live. It is not intended to require loans in those areas that are geographically remote from the FCU's main or branch offices or that contravene the parameters of a Federal credit union's charter. Further. this prohibition does not preclude requiring a borrower to obtain flood insurance protection pursuant to the National Flood Insurance Act and Part 760 of NCUA's Rules and Regulations, nor does it preclude involvement with Federal or state housing insurance programs which provide for lower interest rates for the purchase of homes in certain urban or rural areas. Also, the legitimate use of location factors in an appraisal does not constitute a violation of the provision of paragraph (b)(3) of this section, which prohibits consideration of location of the dwelling. Finally, the prohibited use of prior home ownership does not preclude a Federal credit union from considering an applicant's payment history on a loan which was made to obtain a home. Such action entails consideration of the payment record on a previous loan in determining creditworthiness; it does not entail consideration of prior home ownership.

(3)(i) Paragraph (c)(3) of this section prohibits consideration of the age or location of a dwelling in a real estate-related loan appraisal. These restrictions are intended to prohibit the use of unfounded or unsubstantiated assumptions regarding the effect upon loan risk of the age of a dwelling or the physical or economic characteristics of an area. Appraisals should be based on the present market value of the property offered as security (including consideration of specific improvements to be made by the borrower) and the likelihood that the property will retain an adequate value over the term of the loan.

(ii) The term "age of the dwelling" does not encompass structural soundness. In addition, the age of the dwelling may be used by an appraiser as a basis for conducting further inspections of certain structural aspects of the dwelling. Paragraph (c)(3) of this section does, however, prohibit an unsubstantiated determination that a house over X years in age is not structurally sound.

(iii) With respect to location factors, paragraph (c)(4) of this section recognizes that there may be location factors which may be considered in an appraisal, and requires that the use of any such factors be specifically documented in the appraisal. These factors will most often be those location factors which may negatively affect the short range future value (up to 3–5 years) of a property. Factors which in some cases may cause the market value of a property to decline are recent zoning changes or a significant number of abandoned homes in the immediate vicinity of the property. However, not all zoning changes will cause a decline in property values, and proximity to abandoned buildings may not affect the market value of a property because the cause of abandonment is unrelated to high risk. Proper considerations include the condition and utility of the improvement and various physical factors such as street conditions, amenities such as parks and recreation areas, availability of public utilities and municipal services and exposure to flooding and land faults.

§ 701.32 Payment on shares by public units and nonmembers.

(a) *Authority.* A Federal credit union may, to the extent permitted under Section 107(6) of the Act and this section, receive payments on shares, (regular shares, share certificates, and share draft accounts) from public units and political subdivisions thereof (as those terms are defined in § 745.1) and nonmember credit unions, and to the extent permitted under the Act, this section and § 701.34, receive payments on shares (regular shares, share certificates, and share draft accounts) from other nonmembers.

(b) *Limitations.* (1) Unless a greater amount has been approved by the Regional Director, the maximum amount of all public unit and nonmember shares shall not, at any given time, exceed 20% of the total shares of the federal credit union or $1.5 million, whichever is greater.

(2) Before accepting any public unit or nonmember shares in excess of 20% of total shares, the board of directors must adopt a specific written plan concerning the intended use of these shares and forward a copy of the plan to the Regional Director. The plan must include:

(i) A statement of the credit union's needs, sources and intended uses of public unit and nonmember shares;

(ii) Provision for matching maturities of public unit and nonmember shares with corresponding assets, or justification for any mismatch; and

(iii) Provision for adequate income spread between public unit and nonmember shares and corresponding assets.

(3) A federal credit union seeking an exemption from the limits of paragraph (b)(1) of this section must submit to the Regional Director a written request including:

(i) The new maximum level of public unit and nonmember shares requested, either as a dollar amount or a percentage of total shares;

(ii) The current plan adopted by the credit union's board of directors concerning the use of new public unit and nonmember shares;

(iii) A copy of the credit union's latest financial statement; and

(iv) A copy of the credit union's loan and investment policies.

(4) Where the financial condition and management of the credit union are sound and the credit union's plan for the funds is reasonable, there will be a presumption in favor of granting the request. When granted, exemptions will normally be for a two-year period. The Regional Director will provide a written explanation for an exemption that is granted for a lesser time period.

(5) The Regional Director will provide a written determination on an exemption request within 30 calendar days after receipt of the request. The 30-day period will not begin to run until all necessary information has been submitted to the Regional Director. All denials may be appealed to the NCUA Board in a timely manner. Appeals should be submitted through the Regional Director.

(6) Upon expiration of an exemption, nonmember shares currently in the credit union in excess of the limits established pursuant to (b)(1) of this section will continue to be insured by the National Credit Union Insurance Fund within applicable limits. No new shares in excess of the limits established pursuant to (b)(1) of this section shall be accepted. Existing share certificates in excess of the limits established pursuant to (b)(1) of this section may remain in the credit union only until maturity.

(c) The limitations herein do not apply to accounts maintained in accordance with 701.37 (Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government) and matching funds required by 705.7(b) (Community Development Revolving Loan Program for Credit Unions). Once a loan granted pursuant to Part 705 is repaid, nonmember share deposits accepted to meet the matching requirement are subject to this section.

§ 701.33 Reimbursement, Insurance, and Indemnification of Officials and Employees.

(a) *Official.* An "official" is a person who is or was a member of the board of directors, credit committee or supervisory committee, or other volunteer committee established by the board of directors.

(b) *Compensation.*

(1) Only one board officer, if any, may be compensated as an officer of the board. The bylaws must specify the officer to be compensated, if any, as well as the specific duties of each of the board officers. No other official may receive compensation for performing the duties or responsibilities of the board or committee position to which the person has been elected or appointed.

(2) For purposes of this section, the term "compensation" specifically excludes:

(i) payment (by reimbursement to an official or direct credit union payment to a third party) for reasonable and proper costs incurred by an official in carrying out the responsibilities of the position to which that person has been elected or appointed, if the payment is determined by the board of directors to be necessary or appropriate in order to carry out the official business of the credit union, and is in accordance with written policies and procedures, including documentation requirements, established by the board of directors. Such payments may include the payment of travel costs for officials and one guest per official;

(ii) provision of reasonable health, accident and related types of personal insurance protection, supplied for officials at the expense of the credit union: *Provided,* that such insurance protection must exclude life insurance; must be limited to areas of risk, including accidental death and dismemberment, to which the official is exposed by reason of carrying out the duties or responsibilities of the official's credit union position; must cease immediately upon the insured person's leaving office, without providing residual benefits other than from pending claims, if any; and

(iii) indemnification and related insurance consistent with paragraph (c) of this Section.

(c) *Indemnification.*

(1) A Federal credit union may indemnify its officials and current and former employees for expenses reasonably incurred in connection with judicial or administrative proceedings to which they are or may become parties by reason of the performance of their official duties.

(2) Indemnification shall be consistent either with the standards applicable to credit unions generally in the state in which the principal or home office of the credit union is located, or with the relevant provisions of the Model Business Corporation Act. A Federal credit union that elects to provide indemnification shall specify whether it will follow the relevant state law or the Model Business Corporation Act. Indemnification and the method of indemnification may be provided for by charter or bylaw amendment, contract or board resolution, consistent with the procedural requirements of the applicable state law or the Model Business Corporation Act, as specified. A charter or bylaw amendment must be approved by the National Credit Union Administration.

(3) A Federal credit union may purchase and maintain insurance on behalf of its officials and employees against any liability asserted against them and expenses incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by the applicable state law or the Model Business Corporation Act.

§ 701.34 Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.

(a) *Designation of low-income status.* (1) Section 107(6) of the Federal Credit Union Act (12 U.S.C. 1757(6)) authorizes federal credit unions serving predominantly low-income members to receive shares, share drafts and share certificates from nonmembers. In order to utilize this authority, a federal credit union must receive a low-income designation from its Regional Director. The designation may be removed by the Regional Director upon notice to the federal credit union if the definitions set forth in paragraphs (a) (2) and (3) of this section are no longer met. Removals may be appealed to the NCUA Board within 60 days. Appeals should be submitted through the Regional Director.

(2) The term "low-income members" shall mean those members who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those members whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau or those members otherwise defined as low-income members as determined by order of the NCUA Board.

(i) In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the standards, Regional Directors shall make allowances for geographical areas with higher costs of living. The following is the exclusive list of geographic areas with the differentials to be used:

	Percent
Hawaii	40
Alaska	36
Washington, DC	19
Boston	17
San Diego	15

	Percent
Los Angeles	14
New York	13
San Francisco	13
Seattle	10
Chicago	7
Philadelphia	7

(ii) The term "low-income member" also includes those members who are enrolled as full-time or part-time students in a college, university, high school, or vocational school.

(3) The term "predominantly" is defined as a simple majority.

(b) *Receipt of secondary capital accounts by low-income designated credit unions.* A Federal credit union having a designation of low income status pursuant to paragraph (a) of this section may offer secondary capital accounts to nonnatural person members and nonnatural person nonmembers on the following conditions:

(1) Prior to offering secondary capital accounts, the credit union shall adopt, and forward to the appropriate NCUA Regional Director, a written plan for use of the funds in the secondary capital accounts and subsequent liquidity needs to meet repayment requirements upon maturity of the accounts.

(2) The secondary capital account must be established as a uninsured secondary capital account or other form of non-share account.

(3) The maturity of the secondary capital account must be for a minimum of five years.

(4) The secondary capital account must not be redeemable prior to maturity.

(5) The secondary capital account shall not be insured by the National Credit Union Share Insurance Fund or any governmental or private entity.

(6) The secondary capital account holder's claim against the credit union must be subordinate to all other claims including those of shareholders, creditors and the National Credit Union Share Insurance Fund.

(7) Funds deposited into the secondary capital account, including interest accrued and paid into the secondary capital account, must be available to cover operating losses realized by the credit union that exceed its net available reserves and undivided earnings (*i.e.*, reserves and undivided earnings exclusive of allowance accounts for loan losses), and to the extent funds are so used, the credit union shall under no circumstances restore or replenish the account. The credit union may, in lieu of paying interest into the secondary capital account, pay interest accrued on the secondary capital account directly to the investor or into a separate account from which the secondary capital investor may make withdrawals. Losses shall be distributed pro-rata among all secondary capital accounts held by the credit union at the time the losses are realized.

(8) The secondary capital account may not be pledged or provided by the account-holder as security on a loan or other obligation with the credit union or any other party.

(9) In the event of merger or other voluntary dissolution of the credit union, other than merger into another low-income designated credit union, the secondary capital accounts will, to the extent they are not needed to cover losses at the time of merger or dissolution, be closed and paid out to the account-holder.

(10) A secondary capital account contract agreement must be executed between an authorized representative of the account holder and the credit union accurately establishing the terms and conditions of this section and containing no provisions inconsistent therewith.

(11) A disclosure and acknowledgment as set forth in the Appendix to this section must be provided to and executed by an authorized representative of the secondary capital account holder at the time of entering into the account agreement, and original copies of the account agreement and the disclosure and acknowledgment must be retained by the credit union for the term of the agreement.

(12) As provided in § 702.204(b)(11) of this chapter, 60 days after the effective date of a credit union being classified as "critically undercapitalized" under NCUA's prompt corrective action rules, the NCUA Board may prohibit payments of principal, dividends or interest on the credit union's uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law.

(13) As provided in §§ 702.304(b) and 702.305(b) of this chapter, the NCUA Board may prohibit payments of principal, dividends or interest on the uninsured secondary capital accounts established after August 7, 2000 of a "moderately capitalized", "marginally capitalized", "minimally capitalized" or "uncapitalized" credit union if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory

action prescribed in §§ 702.304(a) or 702.305(a) of this chapter. If NCUA takes this action, unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law.

(c) *Accounting treatment; weighted value for purposes of recognizing capital value of secondary capital accounts.* (1) A low-income designated credit union that issues secondary capital accounts pursuant to paragraph (b) of this section shall record the funds on its balance sheet in an equity account entitled "uninsured secondary capital account." For such accounts with remaining maturities of less than five years, the credit union shall reflect the capital value of the accounts in its financial statement in accordance with the following scale:

(i) Four to less than five years remaining maturity—80 percent.

(ii) Three to less than four years remaining maturity—60 percent.

(iii) Two to less than three years remaining maturity—40 percent.

(iv) One to less than two years remaining maturity—20 percent.

(v) Less than one year remaining maturity—0 percent.

(2) The credit union will reflect the full amount of the secondary capital on deposit in a footnote to its financial statement.

Appendix to § 701.34

Disclosures and acknowledgment in the following form must be provided to any investor in secondary capital accounts in a low-income designated credit union.

An original, signed copy must be retained by the credit union.

Disclosure and Acknowledgment

I, _____ (name of signatory), hereby acknowledge and agree to the following in my capacity as _____ (official position or title) of _____ (name of institutional investor:

- _____ (name of institutional investor) has committed _____ (amount of funds) to a secondary capital account with _____ (name of credit union).
- The funds committed to the secondary capital account are committed for a period of ____ years and are not redeemable prior to _____.
- The secondary capital account is not a share account and the funds committed to the secondary capital account are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.

The funds committed to the secondary capital account and any interest paid into the account may be used by _____ (name of credit union) to cover any and all operating losses that exceed the credit union's reserves and undivided earnings exclusive of allowance accounts for loan losses, and in the event the funds are so used _____ (name of credit union) will under no circumstances restore or replenish those funds to _____ (name of institutional investor).

By initialing below, _____ (name of credit union) _____ and (name of institutional investor) agree that accrued interest will be:

_____ _____ paid into and become part of the secondary capital account;

_____ _____ paid directly to the investor;

_____ _____ paid into a separate account from which the investor may make withdrawals; or

_____ _____ any combination of the above provided the details are specified and agreed to in writing.

- In the event of liquidation of _____ (name of credit union), the funds committed to the secondary capital account shall be *subordinate to all other claims* on the assets of the credit union, including claims of member shareholders, creditors and the National Credit Union Share Insurance Fund.
- The NCUA may prohibit payments of principal, dividends or interest on _____ (name of credit union) uninsured secondary capital accounts established after August 7, 2000, if _____ (name of credit union) has been in operation less than 10 years and has $10 million or less in assets and the provisions of § 701.34(b)(13) of NCUA's regulations are met, or, if _____ (name of credit union) has been in operation for 10 years or more or has more than $10 million in assets and the provisions of § 701.34(b)(12) of NCUA's regulations are met.

_____

(Signature)

_____

(Official Title)

§ 701.35 Share, Share Draft, and Share Certificate Accounts.

(a) Federal credit unions may offer share, share draft, and share certificate accounts in accordance with Section 107(6) of the Act (12 U.S.C. § 1757(6)) and the board of directors may declare dividends on such accounts as provided in Section 117 of the Act (12 U.S.C. § 1763).

(b) A Federal credit union shall accurately represent the terms and conditions of its share, share draft, and share certificate accounts in all advertising, disclosures, or agreements, whether written or oral.

(c) A federal credit union may, consistent with this section, parts 707 and 740 of this subchapter, other federal law, and its contractual obligations, determine the types of fees or charges and other matters affecting the opening maintaining and closing of a share, share draft or share certificate account. State laws regulating such activities are not applicable to federal credit unions.

(d) For purposes of this Section, "state law" means the constitution, statutes, regulations, and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

§ 701.36 FCU Ownership of Fixed Assets.

(a) *A Federal credit union's ownership in fixed assets shall be limited as described in this chapter.*

(b) *Definitions*—As Used in This Section:

(1) Premises includes any office, branch office, suboffice, service center, parking lot, other facility, or real estate where the credit union transacts or will transact business.

(2) Furniture, Fixtures, and Equipment includes all office furnishings, office machines, computer hardware and software, automated terminals, heating and cooling equipment.

(3) Fixed Assets means premises and furniture, fixtures and equipment as these terms are defined above.

(4) Investments in fixed assets means:

(i) any investment in real property (improved or unimproved) which is being used or is intended to be used as premises;

(ii) any leasehold improvement on premises;

(iii) the aggregate of all capital and operating lease payments pursuant to lease agreements for fixed assets;

(iv) any investment in the bonds, stock, debentures, or other obligations of a partnership or corporation, including any entity described in part 712 holding any fixed assets used by the Federal credit union and any loans to such partnership or corporation; or

(v) any investment in furniture, fixtures and equipment.

(5) Abandoned premises means former Federal credit union premises from the date of relocation to new quarters, and property originally acquired for future expansion for which such use is no longer contemplated.

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

(7) Shares mean all savings (regular shares, share drafts, share certificates, other savings) and retained earnings means regular reserve, reserve for contingencies, supplemental reserves, reserve for losses and undivided earnings.

(8) Senior management employee means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(c) *Investment in Fixed Assets.*

(1) No Federal credit union with $1,000,000 or more in assets, without the prior approval of the Administration, shall invest in fixed assets if the aggregate of all such investments exceeds 5 percent of shares and retained earnings.

(2) A Federal credit union shall submit such statement and reports as the NCUA regional director may require in support of any investment in fixed assets in excess of the limit specified above.

(3) If the Administration determines that the proposal will not adversely affect the credit union, an aggregate dollar amount or percentage of assets will be approved for investment in fixed assets. Once such a limit has been approved, and unless otherwise specified by the regional director, a Federal credit union may make future acquisitions of fixed assets, provided the aggregate of all such future investments in fixed assets does not exceed an additional 1 percent of the shares and retained

earnings of the credit union over the amount approved.

(4) Federal credit unions shall submit their requests to the NCUA regional office having jurisdiction over the geographical area in which the credit union's main office is located. The regional office shall inform the requesting credit union, in writing, of the date the request was received. If the credit union does not receive notification of the action taken on its request within 45 calendar days of the date the request was received by the regional office, the credit union may proceed with its proposed investment in fixed assets.

(d) *Premises.*

(1) When real property is acquired for future expansion, at least partial utilization should be accomplished within a reasonable period, which shall not exceed 3 years unless otherwise approved in writing by the Administration. After real property acquired for future expansion has been held for 1 year, a board resolution with definitive plans for utilization must be available for inspection by an NCUA examiner.

(2) A Federal credit union shall endeavor to dispose of "abandoned premises" at a price sufficient to reimburse the Federal credit union for its investment and costs of acquisition. Current documents must be maintained reflecting the Federal credit union's continuing and diligent efforts to dispose of "abandoned premises." After "abandoned premises" have been on the Federal credit union's books for 4 years, the property must be publicly advertised for sale. Disposition must occur through public or private sale within 5 years of abandonment, unless otherwise approved in writing by the Administration.

(e) *Prohibited Transactions.*

(1) With the exception of a short-term informal lease agreement (maturity less than 1 year) no Federal credit union may acquire or lease premises without the prior written approval of the Administration from any of the following:

(i) a director, member of the credit committee or supervisory committee, or senior management employee of the Federal credit union, or immediate family member of any such individual.

(ii) a corporation in which any director, member of the credit committee or supervisory committee, official, or senior management employee, or immediate family members of any such individual, is an officer or director, or has a stock interest of 10 percent or more.

(iii) a partnership in which any director, member of the credit committee or supervisory committee, or senior management employee, or immediate family members of any such individual, is a general partner, or a limited partner with an interest of 10 percent or more.

(2) The prohibition contained in paragraph (e)(1) also applies to any employee not otherwise covered if the employee is directly involved in investments in fixed assets unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(3) All transactions with business associates or family members not specifically prohibited by this subsection (e) must be conducted at arm's length and in the interest of the credit union.

§ 701.37 Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government.

(a) *Definitions.*

(1) "Treasury Tax and Loan ("TT&L") Remittance Account" means a nondividend-paying account, the balance of which is subject to the right of immediate withdrawal, established for receipt of payments of Federal taxes and certain United States obligations under United States Treasury Department regulations.

(2) "TT&L Note Account" means an account subject to the right of immediate call, evidencing funds held by depositaries electing the note option under United States Treasury Department regulations.

(3) "Treasury General Account" means an account, established under United States Treasury Department regulations, in which a zero balance may be maintained and from which the entire balance may be withdrawn by the depositor immediately under all circumstances except closure of the credit union;

(4) "U.S. Treasury Time Deposit-Open Account" means a nondividend-bearing account, established under United States Treasury Department regulations, which generally may not be withdrawn until the expiration of 14 days after the date of the United States Treasury Department's written notice of intent to withdraw.

(b) Subject to regulation of the United States Treasury Department, a Federal credit union may serve as a Treasury tax and loan depositary, a depositary of Federal taxes, a depositary of public money, and a financial agent of the United States Government. In serving in these capacities, a Federal credit union may maintain the accounts defined in subsection (a), pledge collateral, and perform the services described under United States Treasury Department regulations for institutions acting in these capacities.

(c) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and a U.S. Treasury Time Deposit-Open Account shall be considered deposits of public funds. Funds held in a TT&L Remittance Account and a TT&L Note Account shall be added together and insured up to a maximum of $100,000 in the aggregate. Funds held in a Treasury General Account and a U.S. Treasury Time Deposit-Open Account shall be added together and insured up to a maximum of $100,000 in the aggregate.

(d) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and U.S. Treasury Time Deposit-Open Account are not subject to the 60-day notice requirement of Article III, section 5(a) of the Federal Credit Union Bylaws.

§ 701.38 Borrowed Funds From Natural Persons.

(a) Federal credit unions may borrow from a natural person, PROVIDED:

(1) The borrowing is evidenced by a signed promissory note which sets forth the terms and conditions regarding maturity, prepayment, interest rate, method of computation, and method of payment;

(2) The promissory note and any advertisement for such funds contains conspicuous language indicating that:

(i) the note represents money borrowed by the credit union;

(ii) the note does not represent shares and, therefore, is not insured by the National Credit Union Share Insurance Fund.

§ 701.39 Statutory lien.

(a) *Definitions.* Within this section, each of the following terms has the meaning prescribed below:

(1) *Except as otherwise provided by law* or *except as otherwise provided by federal law* is a qualifying phrase referring to a federal and/or state law, as the case may be, which supersedes a requirement of this section. It is the responsibility of the credit union to ascertain whether such statutory or case law exists and is applicable;

(2) *Impress* means to attach to a member's account and is the act which makes the lien enforceable against that account;

(3) *Member* means any member who is primarily, secondarily or otherwise responsible for an outstanding financial obligation to the credit union, including without limitation an obligor, maker, co-maker, guarantor, co-signer, endorser, surety or accommodation party;

(4) *Notice* means written notice to a member disclosing, in plain language, that the credit union has the right to impress and enforce a statutory lien against the member's shares and dividends in the event of failure to satisfy a financial obligation, and may enforce the right without further notice to the member. Such notice must be given at the time, or at any time before, the member incurs the financial obligation;

(5) *Statutory lien* means the right granted by section 107(11) of the Federal Credit Union Act, 12 U.S.C. 1757(11), to a federal credit union to establish a right in or claim to a member's shares and dividends equal to the amount of that member's outstanding financial obligation to the credit union, as that amount varies from time to time.

(b) *Superior claim.* Except as otherwise provided by law, a statutory lien gives the federal credit union priority over other creditors when claims are asserted against a member's account(s).

(c) *Impressing a statutory lien.* Except as otherwise provided by federal law, a credit union can impress a statutory lien on a member's account(s)—

(1) *Account records.* By giving notice thereof in the member's account agreement(s) or other account opening documentation; or

(2) *Loan documents.* In the case of a loan, by giving notice thereof in a loan document signed or otherwise acknowledged by the member(s); or

(3) *By-Law or policy.* Through a duly adopted credit union by-law or policy of the board of directors, of which the member is given notice.

(d) *Enforcing a statutory lien.* (1) *Application of funds.* Except as otherwise provided by federal law, a federal credit union may enforce its statu-

tory lien against a member's account(s) by debiting funds in the account and applying them to the extent of any of the member's outstanding financial obligations to the credit union.

(2) *Default required.* A federal credit union may enforce its statutory lien against a member's account(s) only when the member fails to satisfy an outstanding financial obligation due and payable to the credit union.

(3) *Neither judgment nor set-off required.* A federal credit union need not obtain a court judgment on the member's debt, nor exercise the equitable right of set-off, prior to enforcing its statutory lien against the member's account.

Part 702

Prompt Corrective Action

§ 702.1 Authority, purpose, scope and other supervisory authority.

(a) *Authority.* Subparts A, B and C of this part and subpart L of part 747 of this chapter are issued by the National Credit Union Administration pursuant to section 216 of the Federal Credit Union Act (FCUA), 12 U.S.C. 1790d (section 1790d), as added by section 301 of the Credit Union Membership Access Act, Pub. L. No. 105–219, 112 Stat. 913 (1998). Subpart D of this part is issued pursuant to FCUA section 120, 12 U.S.C. 1766.

(b) *Purpose.* The express purpose of prompt corrective action under section 1790d is to resolve the problems of federally-insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund. This part carries out the purpose of prompt corrective action by establishing a framework of mandatory and discretionary supervisory actions, applicable according to a credit union's net worth ratio, designed primarily to restore and improve the net worth of federally-insured credit unions.

(c) *Scope.* This part implements the provisions of section 1790d as they apply to federally-insured credit unions, whether federally- or state-chartered; to such credit unions defined as "new" pursuant to section 1790d(b)(2); and to such credit unions defined as "complex" pursuant to section 1790d(d). Certain of these provisions also apply to officers and directors of federally-insured credit unions. This part does not apply to corporate credit unions. Procedures for issuing, reviewing and enforcing orders and directives issued under this part are set forth in subpart L of part 747 of this chapter, 12 CFR 747.2001 *et seq.*

(d) *Other supervisory authority.* Neither § 1790d nor this part in any way limits the authority of the NCUA Board or appropriate State official under any other provision of law to take additional supervisory actions to address unsafe or unsound practices or conditions, or violations of applicable law or regulations. Action taken under this part may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA Board or appropriate State official, including issuance of cease and desist orders, orders of prohibition, suspension and removal, or assessment of civil money penalties, or any other actions authorized by law.

§ 702.2 Definitions

Except as provided below, the terms used in this part have the same meanings as set forth in FCUA sections 101 and 216, 12 U.S.C. 1752, 1790d.

(a) *Appropriate regional director* means the director of the NCUA regional office having jurisdiction over federally-insured credit unions in the state where the affected credit union is principally located.

(b) *Appropriate State official* means the commission, board or other supervisory authority having jurisdiction over credit unions chartered by the State which chartered the affected credit union.

(c) *Credit union* means a federally-insured, natural person credit union, whether federally- or State-chartered, as defined by 12 U.S.C. 1752(6).

(d) *CUSO* means a credit union service organization as described in 12 CFR 712 *et seq.* for federally-chartered credit unions, and as defined under State law for State-chartered credit unions.

(e) *NCUSIF* means the National Credit Union Share Insurance Fund as defined by 12 U.S.C. 1783.

(f) *Net worth* means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles. Retained earnings consists of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities. This means that only undivided earnings and appropriations of undivided earnings are included in net worth. 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 NCUSIF. For

any credit union, net worth does not include the allowance for loan and lease losses account.

(g) *Net worth ratio* means the ratio of the net worth of the credit union (as defined in paragraph (f) of this section to the total assets of the credit union (as defined by a measure chosen under paragraph (j) of this section.

(h) *New credit union* means a federally-insured credit union which both has been in operation for less than ten (10) years and has $10,000,000 or less in total assets.

(i) *Senior executive officer* means a senior executive officer as defined by 12 CFR 701.14(b)(2).

(j) *Shares* means deposits, shares, share certificates, share drafts, or any other depository account authorized by federal or state law.

(k) *Total assets*

(1) Total assets means a credit union's total assets as measured by either—

(i) *Average quarterly balance.* The average of quarter-end balances of the current and three preceding calendar quarters; or

(ii) *Average monthly balance.* The average of month-end balances over the three calendar months of the calendar quarter; or

(iii) *Average daily balance.* The average daily balance over the calendar quarter; or

(iv) *Quarter-end balance.* The quarter-end balance of the calendar quarter as reported on the credit union's Call Report.

(2) For each quarter, a credit union must elect a measure of total assets from paragraph (k)(1) of this section to apply for all purposes under this part except §§ 702.103 through 702.108 [risk-based net worth requirement].

(l) *Weighted-average life* means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time), and then summing and dividing by the total amount of principal.

Subpart A—Net Worth Classification

§ 702.101 Measures and effective date of net worth classification

(a) *Net worth measures.* For purposes of this part, a credit union must determine its net worth category classification at the end of each calendar quarter using two measures:

(1) The net worth ratio as defined in § 702.2(g); and

(2) If determined to be applicable under § 702.103, a risk-based net worth requirement.

(b) *Effective date of net worth classification.* For purposes of this part, the effective date of a federally-insured credit union's net worth category classification shall be the most recent to occur of:

(1) *Quarter-end effective date.* The last day of the calendar month following the end of the calendar quarter; or

(2) *Corrected net worth category.* The date the credit union received subsequent written notice from NCUA or, if State-chartered, from the appropriate State official, of a decline in net worth category due to correction of an error or misstatement in the credit union's most recent Call Report; or

(3) *Reclassification to lower category.* The date the credit union received written notice from NCUA or, if State-chartered, the appropriate State official, of reclassification on safety and soundness grounds as provided under §§ 702.102(b) or 702.302(d).

(c) *Notice to NCUA by filing Call Report.* (1) Other than by filing a Call Report, a federally-insured credit union need not notify the NCUA Board of a change in its net worth ratio that places the credit union in a lower net worth category;

(2) Failure to timely file a Call Report as required under this section in no way alters the effective date of a change in net worth classification under this paragraph (b) of this section, or the affected credit union's corresponding legal obligations under this part.

§ 702.102 Statutory net worth categories.

(a) *Net worth categories.* Except for credit unions defined as "new" under subpart B of this part, a federally-insured credit union shall be classified (Table 1)—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater and also meets any applicable risk-based net worth requirement under §§ 702.103 through 702.108; or

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%), and also meets any applicable risk-based net worth requirement under §§ 702.103 through 702.108 below; or

(3) *Undercapitalized* if it has a net worth ratio of four percent (4%) or more but less than six percent (6%), or fails to meet any applicable risk-based net worth requirement under §§ 702.103 through 702.108; or

(4) *Significantly undercapitalized* if it

(i) Has a net worth ratio of two percent (2%) or more but less than four percent (4%); or

(ii) Has a net worth ratio of four percent (4%) or more but less than five percent (5%), and either—

(A) Fails to submit an acceptable net worth restoration plan within the time prescribed in § 702.206; or

(B) Materially fails to implement a net worth restoration plan approved by the NCUA Board; or

(5) *Critically undercapitalized* if it has a net worth ratio of less than two percent (2%).

TABLE 1 – STATUTORY NET WORTH CATEGORY CLASSIFICATION

A credit union's net worth category is . . .	*if its net worth ratio is . . .*	*and subject to the following condition(s) . . .*
"Well Capitalized"	7% or above	Meets applicable risk-based net worth (RBNW) requirement
"Adequately Capitalized"	6% to 6.99%	Meets applicable RBNW requirement
"Undercapitalized"	4% to 5.99%	Or fails applicable RBNW requirement
"Significantly Undercapitalized"	2% to 3.99%	Or if "undercapitalized" at <5% net worth ratio and fails to timely submit or materially implement Net Worth Restoration Plan
"Critically Undercapitalized"	Less than 2%	None

(b) *Reclassification based on supervisory criteria other than net worth.* The NCUA Board may reclassify a "well capitalized" credit union as "adequately capitalized" and may require an "adequately capitalized" or "undercapitalized" credit union to comply with certain mandatory or discretionary supervisory actions as if it were in the next lower net worth category (each of such actions hereinafter referred to generally as "reclassification") in the following circumstances:

(1) *Unsafe or unsound condition.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union is in an unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(c) *Non-delegation.* The NCUA Board may not delegate its authority to reclassify a credit union under paragraph (b) of this section.

(d) *Consultation with State officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before reclassifying a federally-insured State-chartered credit union under paragraph (b) of this section, and shall promptly notify the appropriate State official of its decision to reclassify.

§ 702.103 Applicability of risk-based net worth requirement.

For purposes of § 702.102, a credit union is defined as "complex" and a risk-based net worth requirement is applicable only if the credit union meets both of the following criteria as reflected its most recent Call Report:

(a) *Minimum asset size.* Its quarter-end total assets exceed ten million dollars ($10,000,000); and

(b) *Minimum RBNW calculation.* Its risk-based net worth requirement as calculated under § 702.106 exceeds six percent (6%).

§ 702.104 Risk portfolios defined.

A risk portfolio is a portfolio of assets, liabilities, or contingent liabilities as specified below, each expressed as a percentage of the credit union's quarter-end total assets reflected in its most recent Call Report, rounded to two decimal places (Table 2):

(a) *Long-term real estate loans.* Total real estate loans and real estate lines of credit outstanding, exclusive of those outstanding that will contractually refinance, reprice or mature within the next five (5) years, and exclusive of all member business loans (as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20);

(b) *Member business loans outstanding.* All member business loans as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20;

(c) *Investments.* Investments as defined by 12 CFR 703.150 or applicable State law, including investments in CUSOs (as defined by § 702.2(d));

(d) *Low-risk assets.* Cash on hand (*e.g.,* coin and currency, including vault, ATM and teller cash) and the NCUSIF deposit;

(e) *Average-risk assets.* One hundred percent (100%) of total assets minus the sum of the risk portfolios in paragraphs (a) through (d) of this section;

(f) *Loans sold with recourse.* Outstanding balance of loans sold or swapped with recourse, excluding loans sold to the secondary mortgage market that have representations and warranties consistent with those customarily required by the U.S. Government and government sponsored enterprises;

(g) *Unused member business loan commitments.* Unused commitments for member business loans as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20; and

(h) *Allowance.* The Allowance for Loan and Lease Losses not to exceed the equivalent of one and one-half percent (1.5%) of total loans outstanding.

TABLE 2 -- §702.104 RISK PORTFOLIOS DEFINED

Risk portfolio	*Assets, liabilities or contingent liabilities*
(a) Long-term real estate loans	Total real estate loans and real estate lines of credit (excluding MBLs) with a maturity (and next rate adjustment period if variable rate) greater than 5 years
(b) MBLs outstanding	Member business loans outstanding
(c) Investments	As defined by federal regulation or applicable State law.
(d) Low-risk assets	Cash on hand and NCUSIF deposit.
(e) Average-risk assets	100% of total assets minus sum of risk portfolios above
(f) Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse, except for loans sold to the secondary mortgage market with a recourse period of 1 year or less.
(g) Unused MBL commitments	Unused commitments for MBLs
(h) Allowance	Allowance for Loan and Lease Losses limited to equivalent of 1.50 percent of total loans

§ 702.105 Weighted-average life of investments.

Except as provided below (Table 3), the weighted-average life of an investment for purposes of §§ 702.106(c) and 702.107(c) is defined pursuant to § 702.2(m):

(a) *Registered investment companies and collective investment funds.*

(1) For investments in registered investment companies (*e.g.,* mutual funds) and collective investment funds, the weighted-average life is defined as the maximum weighted-average life disclosed, directly or indirectly, in the prospectus or trust instrument;

(2) For investments in money market funds, as defined in 17 CFR 270.2a–7, and collective investment funds operated in accordance with short-term investment fund rules set forth in 12 CFR 9.18(b)(4)(ii)(B)(1)–(3), the weighted-average life is defined as one (1) year or less; and

(3) For other investments in registered investment companies or collective investment funds, the weighted-average life is defined as greater than five (5) years, but less than or equal to seven (7) years;

(b) *Callable fixed-rate debt obligations and deposits.* For fixed-rate debt obligations and deposits that are callable in whole, the weighted-average life is defined as the period remaining to the maturity date;

(c) *Variable-rate debt obligations and deposits.* For variable-rate debt obligations and deposits, the weighted-average life is defined as the period remaining to the next rate adjustment date;

(d) *Capital in mixed-ownership Government corporations and corporate credit unions.* For capital stock in mixed-ownership Government corporations, as defined in 31 U.S.C. 9101(2), and member paid-in capital and membership capital in corporate credit unions, as defined in 12 CFR 704.2, the weighted-average life is defined as greater than one (1) year, but less than or equal to three (3) years;

(e) *Investments in CUSOs.* For investments in CUSOs (as defined in § 702.2(d)), the weighted-average life is defined as greater than one (1) year, but less than or equal to three (3) years; and

(f) *Other equity securities.* For other equity securities, the weighted average life is defined as greater than ten (10) years.

TABLE 3 -- §702.105 WEIGHTED-AVERAGE LIFE OF INVESTMENTS

Investment	*Weighted-average life*
(a) Registered investment companies and collective investment funds	i. *Registered investment companies and collective investment funds*: As disclosed in prospectus or trust instrument, but if not disclosed, greater than five (5) years, but less than or equal to seven (7) years. ii. *Money market funds and STIFs*: One (1) year or less.
(b) Callable fixed-rate debt obligations and deposits	Period remaining to maturity date.
(c) Variable-rate debt obligations and deposits	Period remaining to next rate adjustment date.
(d) Capital in mixed-ownership Government corporations and corporate credit unions	Greater than one (1) year, but less than or equal to three (3) years.
(e) Investments in CUSOs	Greater than one (1) year, but less than or equal to three (3) years.
(f) Other equity securities	Greater than ten (10) years.

§ 702.106 Standard calculation of risk-based net worth requirement.

A credit union's risk-based net worth requirement is the aggregate of the following standard component amounts, each expressed as a percentage of the credit union's quarter-end total assets as reflected in its most recent Call Report, rounded to two decimal places (Table 4):

(a) *Long-term real estate loans.* The sum of:

(1) Six percent (6%) of the amount of long-term real estate loans less than or equal to twenty-five percent (25%) of total assets; and

(2) Fourteen percent (14%) of the amount in excess of twenty-five percent (25%) of total assets;

(b) *Member business loans outstanding.* The sum of:

(1) Six percent (6%) of the amount of member business loans outstanding less than or equal to fifteen percent (15%) of total assets;

(2) Eight percent (8%) of the amount of member business loans outstanding greater than fifteen percent (15%), but less than or equal to twenty-five percent (25%), of total assets; and

(3) Fourteen percent (14%) of the amount in excess of twenty-five percent (25%) of total assets;

(c) *Investments.* The sum of:

(1) Three percent (3%) of the amount of investments with a weighted-average life (as specified in § 702.105 above) of one (1) year or less;

(2) Six percent (6%) of the amount of investments with a weighted-average life greater than one (1) year, but less than or equal to three (3) years;

(3) Twelve percent (12%) of the amount of investments with a weighted-average life greater than three (3) years, but less than or equal to ten (10) years; and

(4) Twenty percent (20%) of the amount of investments with a weighted-average life greater than ten (10) years;

(d) *Low-risk assets.* Zero percent (0%) of the entire portfolio of low-risk assets;

(e) *Average-risk assets.* Six percent (6%) of the entire portfolio of average-risk assets;

(f) *Loans sold with recourse.* Six percent (6%) of the entire portfolio of loans sold with recourse;

(g) *Unused member business loan commitments.* Six percent (6%) of the entire portfolio of unused member business loan commitments; and

(h) *Allowance.* Negative one hundred percent (−100%) of the balance of the Allowance for Loan and Lease Losses account, not to exceed the equivalent of one and one-half percent (1.5%) of total loans outstanding.

TABLE 4 -- §702.106 STANDARD CALCULATION OF RBNW REQUIREMENT

Risk portfolio	*Amount of risk portfolio (as percent of quarter-end total assets) to be multiplied by risk weighting*	*Risk weighting*
(a) Long-term real estate loans	0 to 25.00% over 25.00%	.06 .14
(b) MBLs outstanding	0 to 15.00% >15.00% to 25.00% over 25.00%	.06 .08 .14
(c) Investments	*By weighted-average life*: 0 to 1 year >1year to 3 years >3 years to 10 years >10 years	.03 .06 .12 .20
(d) Low-risk assets	All %	.00
(e) Average-risk assets	All %	.06
(f) Loans sold with recourse	All %	.06
(g) Unused MBL commitments	All %	.06
(h) Allowance	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)
A credit union's RBNW requirement is the sum of eight standard components. A standard component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its risk weighting. A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement.		

§ 702.107 Alternative components for standard calculation.

A credit union may substitute one or more alternative components below, in place of the corresponding standard components in § 702.106 above, when any alternative component amount, expressed as a percentage of the credit union's quarter-end total assets as reflected in its most recent Call Report, rounded to two decimal places, is smaller (Table 5):

(a) *Long-term real estate loans.* The sum of:

(1) *Non-callable.* Non-callable long-term real estate loans as follows:

(i) Eight percent (8%) of the amount of such loans with a remaining maturity of greater than 5 years, but less than or equal to 12 years;

(ii) Twelve percent (12%) of the amount of such loans with a remaining maturity of greater than 12 years, but less than or equal to 20 years; and

(iii) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 20 years;

(2) *Callable.* Long-term real estate loans callable in 5 years or less as follows:

(i) Six percent (6%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 5 years, but less than or equal to 12 years;

(ii) Ten percent (10%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 12 years, but less than or equal to 20 years; and

(iii) Twelve percent (12%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 20 years;

(b) *Member business loans outstanding.* The sum of:

(1) *Fixed rate.* Fixed-rate member business loans outstanding as follows:

(i) Six percent (6%) of the amount of such loans with a remaining maturity of 3 or fewer years;

(ii) Nine percent (9%) of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;

(iii) Twelve percent (12%) of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;

(iv) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and

(v) Sixteen percent (16%) of the amount of such loans with a remaining maturity greater than 12 years; and

(2) *Variable-rate.* Variable-rate member business loans outstanding as follows:

(i) Six percent (6%) of the amount of such loans with a remaining maturity of 3 or fewer years;

(ii) Eight percent (8%) of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;

(iii) Ten percent (10%) of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;

(iv) Twelve percent (12%) of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and

(v) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 12 years.

(c) *Investments.* The sum of:

(1) Three percent (3%) of the amount of investments with a weighted-average life (as specified in § 702.105 above) of one (1) year or less;

(2) Six percent (6%) of the amount of investments with a weighted-average life greater than one (1) year, but less than or equal to three (3) years;

(3) Eight percent (8%) of the amount of investments with a weighted-average life greater than three (3) years, but less than or equal to five (5) years;

(4) Twelve percent (12%) of the amount of investments with a weighted-average life greater than five (5) years, but less than or equal to seven (7) years;

(5) Sixteen percent (16%) of the amount of investments with a weighted-average life greater than seven (7) years, but less than or equal to ten (10) years; and

(6) Twenty percent (20%) of the amount of investments with a weighted-average life greater than ten (10) years.

(d) *Loans sold with recourse.* The alternative component is the sum of:

(1) Six percent (6%) of the amount of loans sold with contractual recourse obligations of six percent (6%) or greater; and

(2) The weighted average recourse percent of the amount of loans sold with contractual recourse obligations of less than six percent (6%), as computed by the credit union.

TABLE 5 -- §702.107 ALTERNATIVE COMPONENTS FOR STANDARD CALCULATION

(a) LONG-TERM REAL ESTATE LOANS

Amount of long-term real estate loans by remaining maturity	*Alternative risk weighting*
Non-callable long-term real estate loans *Remaining maturity:* > 5 years to 12 years	.08
> 12 years to 20 years	.12
> 20 years	.14
Long-term real estate loans callable in 5 years or less *Remaining maturity:* > 5 years to 12 years	.06
> 12 years to 20 years	.10
> 20 years	.12
The "alternative component" is the sum of each amount of the "long-term real estate loans" risk portfolio by non-"callable" and "callable" characteristic and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(b) MEMBER BUSINESS LOANS

Amount of member business loans by remaining maturity	*Alternative risk weighting*
Fixed-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.09
> 5 years to 7 years	.12
> 7 years to 12 years	.14
> 12 years	.16
Variable-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.08
> 5 years to 7 years	.10
> 7 years to 12 years	.12
> 12 years	.14
The "alternative component" is the sum of each amount of the member business loans risk portfolio by fixed and variable rate and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(c) INVESTMENTS

Amount of investments by weighted-average life	*Alternative risk weighting*
0 to 1 year	.03
>1 year to 3 years	.06
>3 years to 5 years	.08
>5 years to 7 years	.12
>7 years to 10 years	.16
> 10 years	.20
The "alternative component" is the sum of each amount of the Investments risk portfolio by weighted-average life (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(d) LOANS SOLD WITH RECOURSE

Amount of loans by recourse	*Alternative risk weighting*
Recourse 6% or greater	.06
Recourse <6%	Weighted average recourse percent
The "alternative component" is the sum of each amount of the "loans sold with recourse" risk portfolio by level of recourse (as a percent of quarter-end total assets) times its alternative factor. The alternative factor for loans sold with recourse of less than 6% is equal to the weighted average recourse percent on such loans. A credit union must compute the weighted average recourse percent for its loans sold with recourse of less than six percent (6%). Substitute for corresponding standard component if smaller.	

§ 702.108 Risk mitigation credit.

(a) *Who may apply.* A credit union may apply for a risk mitigation credit if on any of the current or three preceding effective dates of classification it either failed an applicable RBNW requirement or met it by less than 100 basis points.

(b) *Application for credit.* Upon application pursuant to guidelines duly adopted by the NCUA Board, the NCUA Board may in its discretion grant a credit to reduce a risk-based net worth requirement under §§ 702.106 and 702.107 upon proof of mitigation of:

(1) Credit risk; or

(2) Interest rate risk as demonstrated by economic value exposure measures.

(c) *Application by FISCU.* In the case of a FISCU seeking a risk mitigation credit—

(1) Before an application under paragraph (a) above may be submitted to the NCUA Board, it must be submitted in duplicate to the appropriate State official and the appropriate Regional Director; and

(2) The NCUA Board, when evaluating the application of a FISCU, shall consult and seek to work cooperatively with the appropriate State official, and shall provide prompt notice of its decision to the appropriate State official.

APPENDICES A–H TO SUBPART A OF PART 702

APPENDIX A – EXAMPLE STANDARD COMPONENTS FOR RBNW REQUIREMENT, §702.106
(EXAMPLE CALCULATION IN BOLD)

Risk portfolio	***Dollar balance***	***Amount as percent of quarter-end total assets***	*Risk weighting*	***Amount times risk weighting***	***Standard component***
Quarter-end total assets	**200,000,000**	**100.0000 %**			
(a) Long-term real estate loans	**60,000,000**	**30.0000 % =**			**2.20 %**
Threshold amount: 0 to 25%		**25.0000 %**	.06	**1.5000 %**	
Excess amount: over 25%		**5.0000 %**	.14	**0.7000 %**	
(b) MBLs outstanding	**35,000,000**	**17.5000 % =**			**1.10 %**
Threshold amount: 0 to 15%		**15.0000 %**	.06	**0.9000 %**	
Intermediate tier: >15% to 25%		**2.5000 %**	.08	**0.2000 %**	
Excess amount: over 25%		**0.0 %**	.14	**0.0 %**	
(c) Investments	**50,000,000 =**	**25.0000 % =**			**1.51 %**
Weighted-average life:					
0 to 1 year	**24,000,000**	**12.0000 %**	.03	**0.3600 %**	
>1 year to 3 years	**15,000,000**	**7.5000 %**	.06	**0.4500 %**	
>3 years to 10 years	**10,000,000**	**5.0000 %**	.12	**0.6000 %**	
>10 years	**1,000,000**	**0.5000 %**	.20	**0.1000 %**	
(d) Low-risk assets	**4,000,000**	**2.0000 %**	.00		**0 %**
Sum of risk portfolios (a) through (d) above	**149,000,000**	**74.5.000%**			
(e) Average-risk assets	**51,000,000**	**25.5000 %**[a]	.06		**1.53 %**
(f) Loans sold with recourse	**40,000,000**	**20.0000 %**	.06		**1.20 %**
(g) Unused MBL commitments	**5,000,000**	**2.5000 %**	.06		**0.15 %**
(h) Allowance	**2,040,000.00** [b]	**1.0200 %**	(1.00)		**(1.02) %**
Sum of standard components: **RBNW requirement** [c]					**6.67 %**

[a] The Average-risk assets risk portfolio percent of quarter-end total assets equals 100 percent minus the sum of the percentages in the four risk portfolios above (*e.g.,* Long-term real estate loans, MBLs outstanding, Investments, and Low-risk assets).

[b] The Allowance risk portfolio is limited to the equivalent of 1.50 percent of total loans. For an example computation of the permitted dollar balance of Allowance, see worksheet in Appendix B below.

[c] A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement. The dollar equivalent of RBNW requirement may be computed for informational purposes as the RBNW requirement percent of total assets.

APPENDIX B – ALLOWANCE RISK PORTFOLIO DOLLAR BALANCE WORKSHEET
(EXAMPLE CALCULATION IN BOLD)

Balance sheet account	***Dollar balance***	***Percent of total loans***	*Range of ALL permitted*	***Permitted ALL percent of total loans***	***Permitted dollar balance of Allowance***
Allowance for Loan and Lease Losses (ALL)	**2,400,000**	**1.7647%**	0 to 1.50%	**1.50%**	**2,040,000**
Total loans	**136,000,000**				

APPENDIX C – EXAMPLE LONG-TERM REAL ESTATE LOANS ALTERNATIVE COMPONENT, §702.107(a)
(EXAMPLE CALCULATION IN BOLD)

Remaining maturity	**Dollar balance of Long-term real estate loans by remaining maturity**	**Percent of total assets by remaining maturity**	Alternative risk weighting	**Alternative component**
Non-callable long-term real estate loans				
> 5 years to 12 years	**15,000,000**	**7.5000 %**	.08	**0.6000 %**
> 12 years to 20 years	**2,500,000**	**1.2500 %**	.12	**0.1500 %**
> 20 years	**2,500,000**	**1.2500 %**	.14	**0.1750 %**
Long-term real estate loans callable in 5 years or less				
> 5 years to 12 years	**35,000,000**	**17.5000 %**	.06	**1.0500 %**
> 12 years to 20 years	**5,000,000**	**2.5000 %**	.10	**0.2500 %**
> 20 years	**0**	**0.000 %**	.12	**0.000 %**
Sum of above equals Alternative Component*				**2.23 %**

*Substitute for standard component if lower.

APPENDIX D – EXAMPLE OF MEMBER BUSINESS LOANS ALTERNATIVE COMPONENT, §702.107(b)
(EXAMPLE CALCULATION IN BOLD)

Remaining maturity	***Dollar balance of MBLs by remaining maturity***	***Percent of total assets by remaining maturity***	*Alternative risk weighting*	***Alternative component***
Fixed-rate MBLs 0 to 3 years	**6,000,000**	**3.0000 %**	.06	**0.1800 %**
> 3 years to 5 years	**4,000,000**	**2.0000 %**	.09	**0.1800 %**
> 5 years to 7 years	**2,000,000**	**1.0000 %**	.12	**0.1200 %**
> 7 years to 12 years	**0**	**0.0000 %**	.14	**0.0000 %**
> 12 years	**0**	**0.0000 %**	.16	**0.0000 %**
Variable-rate MBLs 0 to 3 years	**17,000,000**	**8.5000 %**	.06	**0.5100 %**
> 3 years to 5 years	**4,000,000**	**2.0000 %**	.08	**0.1600 %**
> 5 years to 7 years	**2,000,000**	**1.0000 %**	.10	**0.1000 %**
> 7 years to 12 years	**0**	**0.0000 %**	.12	**0.0000 %**
>12 years	**0**	**0.0000 %**	.14	**0.0000 %**
Sum of above equals Alternative component*				**1.25 %**

* Substitute for standard component if lower.

APPENDIX E -- EXAMPLE OF INVESTMENTS ALTERNATIVE COMPONENT, §702.107(c)

(EXAMPLE CALCULATION IN BOLD)

Weighted-average life	***Dollar balance of investments by weighted-average life***	***Percent of total assets by weighted-average life***	*Alternative risk weighting*	***Alternative component***
0 to 1 year	**24,000,000**	**12.0000 %**	.03	**0.3600 %**
> 1 year to 3 years	**15,000,000**	**7.5000 %**	.06	**0.4500 %**
> 3 years to 5 years	**8,000,000**	**4.0000 %**	.08	**0.3200 %**
> 5 years to 7 years	**1,000,000**	**0.5000 %**	.12	**0.0600 %**
> 7 years to 10 years	**1,000,000**	**0.5000 %**	.16	**0.0800 %**
> 10 years	**1,000,000**	**0.5000 %**	.20	**0.1000 %**
Sum of above equals Alternative component*				**1.37 %**

* Substitute for standard component if lower.

APPENDIX F – EXAMPLE LOANS SOLD WITH RECOURSE ALTERNATIVE COMPONENT, §702.107(d)

(EXAMPLE CALCULATION IN BOLD)

Percent of contractual recourse obligation	***Dollar balance of Loans sold with recourse***	***Percent of total assets***	***Alternative risk weighting***	***Alternative component***
Recourse 6 % or greater	**5,000,000**	**2.5000 %**	.06	**0.1500 %**
Recourse < 6 %	**35,000,000**	**17.5000 %**	.0500 [a/]	**0.8750 %**
Sum of above equals Alternative component*				**1.03 %**

* Substitute for corresponding standard component if lower.

[a/] The credit union must calculate this alternative risk weighting for loans sold with recourse of less than 6 %. For an example computation, see worksheet in Appendix G below.

APPENDIX G –WORKSHEET FOR ALTERNATIVE RISK WEIGHTING OF LOANS SOLD WITH CONTRACTUAL RECOURSE OBLIGATIONS OF LESS THAN 6 %

(EXAMPLE CALCULATION IN BOLD)

Percent of contractual recourse obligation less than 6%	***Dollar balance of loans sold with recourse***	***Dollars of recourse***	***Alternative risk weighting***
5.50 %	**5,000,000**	**275,000**	
5.00 %	**25,000,000**	**1,250,000**	
4.50 %	**5,000,000**	**225,000**	
Sum of above equals	**35,000,000**	**1,750,000**	
Dollar of recourse divided by dollar balance equals (expressed as %)			**5.00 %**

APPENDIX H -- EXAMPLE RBNW REQUIREMENT USING ALTERNATIVE COMPONENTS
(EXAMPLE CALCULATION IN BOLD)

Risk portfolio	***Standard component***	***Alternative component***	***Lower of standard or alternative component***
(a) Long-term real estate loans	**2.20 %**	**2.85 %**	**2.20 %**
(b) MBLs outstanding	**1.10 %**	**1.25 %**	**1.10 %**
(c) Investments	**1.51 %**	**1.37 %**	**1.37 %**
(f) Loans sold with recourse	**1.20%**	**1.03%**	**1.03%**
			Standard component
(d) Low-risk assets			**0 %**
(e) Average-risk assets			**1.53 %**
(g) Unused MBL commitments			**0.15 %**
(h) Allowance			**(1.02) %**
RBNW requirement* Compare to Net Worth Ratio			**6.53 %**

* A credit union is "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement

Subpart B—Mandatory and Discretionary Supervisory Actions

§ 702.201 Prompt corrective action for "adequately capitalized" credit unions.

(a) *Earnings retention.* Beginning the effective date of classification as "adequately capitalized" or lower, a federally-insured credit union must increase the dollar amount of its net worth quarterly either in the current quarter, or on average over the current and three preceding quarters, by an amount equivalent to at least 1/10th percent (0.1%) of its total assets, and must quarterly transfer that amount (or more by choice) from undivided earnings to its regular reserve account until it is "well capitalized."

(b) *Decrease in retention.* Upon written application received no later than 14 days before the quarter end, the NCUA Board, on a case-by-case basis, may permit a credit union to increase the dollar amount of its net worth and quarterly transfer an amount that is less than the amount required under paragraph (a) of this section, to the extent the NCUA Board determines that such lesser amount—

(1) Is necessary to avoid a significant redemption of shares; and

(2) Would further the purpose of this part.

(c) *Decrease by FISCU.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before permitting a federally-insured State-chartered credit union to decrease its earnings retention under paragraph (b) of this section.

(d) *Periodic review.* A decision under paragraph (b) of this section to permit a credit union to decrease its earnings retention is subject to quarterly review and revocation except when the credit union is operating under an approved net worth restoration plan that provides for decreasing its earnings retention as provided under paragraph (b).

§ 702.202 Prompt corrective action for "undercapitalized" credit unions

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is "undercapitalized" must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.206, *provided however,* that a credit union in this category having a net worth ratio of less

than five percent (5%) which fails to timely submit such a plan, or which materially fails to implement an approved plan, is classified "significantly undercapitalized" pursuant to § 702.102(a)(4)(ii) above;

(3) *Restrict increase in assets.* Beginning the effective date of classification as "undercapitalized" or lower, not permit the credit union's assets to increase beyond its total assets (per § 702.2(j)) for the preceding quarter unless—

(i) *Plan approved.* The NCUA Board has approved a net worth restoration plan which provides for an increase in total assets and—

(A) The assets of the credit union are increasing consistent with the approved plan; and

(B) The credit union is implementing steps to increase the net worth ratio consistent with the approved plan;

(ii) *Plan not approved.* The NCUA Board has not approved a net worth restoration plan and total assets of the credit union are increasing because of increases since quarter-end in balances of:

(A) Total accounts receivable and accrued income on loans and investments; or

(B) Total cash and cash equivalents; or

(C) Total loans outstanding, not to exceed the sum of total assets (per § 702.2(j)) plus the quarter-end balance of unused commitments to lend and unused lines of credit provided however that a credit union which increases a balance as permitted under paragraphs (A), (B) or (C) cannot offer rates on shares in excess of prevailing rates on shares in its relevant market area, and cannot open new branches;

(4) *Restrict member business loans.* Beginning the effective date of classification as "undercapitalized" or lower, not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *"Second tier" discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to an "undercapitalized" credit union having a net worth ratio of less than five percent (5%), or a director, officer or employee of such a credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, unless the NCUA Board has approved the credit union's net worth restoration plan, the credit union is implementing its plan, and the NCUA Board determines that the proposed action is consistent with and will further the objectives of that plan;

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to reduce or divest its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates the credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the relevant market area, as determined by the NCUA Board, except that dividend rates already declared on shares acquired before imposing a restriction under this paragraph may not be retroactively restricted;

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce its assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however,* that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(8) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval); and

(9) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board deter-

mines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (8) of this section.

(c) *"First tier" application of discretionary supervisory actions.* An "undercapitalized" credit union having a net worth ratio of five percent (5%) or more, or which is classified "undercapitalized" by reason of failing to satisfy a risk-based net worth requirement under § 702.105 or 702.106, is subject to the discretionary supervisory actions in paragraph (b) of this section if it fails to comply with any mandatory supervisory action in paragraph (a) of this section or fails to timely implement an approved net worth restoration plan under § 702.206, including meeting its prescribed steps to increase its net worth ratio.

§ 702.203 Prompt corrective action for "significantly undercapitalized" credit unions.

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is "significantly undercapitalized" must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.206;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in § 702.202(a)(3) and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in § 702.202(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any "significantly undercapitalized" credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided in § 702.202(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.202(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union's board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however,* that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers' compensation.* Except with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as "significantly undercapitalized," and prohibit payment of a bonus or profit share to such officer;

(11) *Other actions to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (10) of this section; and

(12) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the

credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Discretionary conservatorship or liquidation if no prospect of becoming "adequately capitalized."* Notwithstanding any other actions required or permitted to be taken under this section, when a credit union becomes "significantly undercapitalized" (including by reclassification under section 702.102(b) above), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming "adequately capitalized."

§ 702.204 Prompt corrective action for "critically undercapitalized" credit unions

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is "critically undercapitalized" must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.206;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in § 702.202(a)(3); and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in § 702.202(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any "critically undercapitalized" credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided by § 702.202(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.202(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union's board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however,* that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers' compensation.* Reduce or, with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as "critically undercapitalized," and prohibit payment of a bonus or profit share to such officer;

(11) *Restrictions on payments on uninsured secondary capital.* Beginning 60 days after the effective date of classification of a credit union as "critically undercapitalized," prohibit payments of principal, dividends or interest on the credit union's uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law;

(12) *Requiring prior approval.* Require a "critically undercapitalized" credit union to obtain the NCUA Board's prior written approval before doing any of the following:

(i) Entering into any material transaction not within the scope of an approved net worth restoration plan (or approved revised business plan under subpart C of this part);

(ii) Extending credit for transactions deemed highly leveraged by the NCUA Board or, if State-chartered, by the appropriate State official;

(iii) Amending the credit union's charter or bylaws, except to the extent necessary to comply with any law, regulation, or order;

(iv) Making any material change in accounting methods; and

(v) Paying dividends or interest on new share accounts at a rate exceeding the prevailing rates of interest on insured deposits in its relevant market area;

(13) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (12) of this section; and

(14) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Mandatory conservatorship, liquidation or action in lieu thereof*—(1) *Action within 90 days.* Notwithstanding any other actions required or permitted to be taken under this section (and regardless of a credit union's prospect of becoming "adequately capitalized"), the NCUA Board must, within 90 calendar days after the effective date of classification of a credit union as "critically undercapitalized"—

(i) *Conservatorship.* Place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(G); or

(ii) *Liquidation.* Liquidate the credit union pursuant to 12 U.S.C. 1787(a)(3)(A)(ii); or

(iii) *Other corrective action.* Take other corrective action, in lieu of conservatorship or liquidation, to better achieve the purpose of this part, provided that the NCUA Board documents why such action in lieu of conservatorship or liquidation would do so, *provided however,* that other corrective action may consist, in whole or in part, of complying with the quarterly timetable of steps and meeting the quarterly net worth targets prescribed in an approved net worth restoration plan.

(2) *Renewal of other corrective action.* A determination by the NCUA Board to take other corrective action in lieu of conservatorship or liquidation under paragraph (c)(1)(iii) of this section shall expire after an effective period ending no later than 180 calendar days after the determination is made, and the credit union shall be immediately placed into conservatorship or liquidation under paragraphs (c)(1)(i) and (ii), unless the NCUA Board makes a new determination under paragraph (c)(1)(iii) of this section before the end of the effective period of the prior determination;

(3) *Mandatory liquidation after 18 months*—(i) *Generally.* Notwithstanding paragraphs (c)(1) and (2) of this section, the NCUA Board must place a credit union into liquidation if it remains "critically undercapitalized" for a full calendar quarter, on a monthly average basis, following a period of 18 months from the effective date the credit union was first classified "critically undercapitalized."

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, the NCUA Board may continue to take other corrective action in lieu of liquidation if it certifies that the credit union—

(A) Has been in substantial compliance with an approved net worth restoration plan requiring consistent improvement in net worth since the date the net worth restoration plan was approved;

(B) Has positive net income or has an upward trend in earnings that the NCUA Board projects as sustainable; and

(C) Is viable and not expected to fail.

(iii) *Review of exception.* The NCUA Board shall, at least quarterly, review the certification of an exception to liquidation under paragraph (c)(3)(ii) of this section and shall either—

(A) Recertify the credit union if it continues to satisfy the criteria of paragraph (c)(3)(ii) of this section; or

(B) Promptly place the credit union into liquidation, pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), if it fails to satisfy the criteria of paragraph (c)(3)(ii) of this section.

(4) *Nondelegation.* The NCUA Board may not delegate its authority under paragraph (c) of this section, unless the credit union has less

than $5,000,000 in total assets. A credit union shall have a right of direct appeal to the NCUA Board of any decision made by delegated authority under this section within ten (10) calendar days of the date of that decision.

(d) *Mandatory liquidation of insolvent federal credit union.* In lieu of paragraph (c) of this section, a "critically undercapitalized" federal credit union that has a net worth ratio of less than zero percent (0%) may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

§ 702.205 Consultation with State officials on proposed prompt corrective action.

(a) *Consultation on proposed conservatorship or liquidation.* Before placing a federally-insured State-chartered credit union into conservatorship (pursuant to 12 U.S.C. 1786(h)(1)(F) or (G)) or liquidation (pursuant to 12 U.S.C. 1787(a)(3)) as permitted or required under subparts B or C of this part to facilitate prompt corrective action—

(1) The NCUA Board shall seek the views of the appropriate State official (as defined in § 702.2(b), and give him or her an opportunity to take the proposed action;

(2) The NCUA Board shall, upon timely request of the appropriate State official, promptly provide him or her with a written statement of the reasons for the proposed conservatorship or liquidation, and reasonable time to respond to that statement; and

(3) If the appropriate State official makes a timely written response that disagrees with the proposed conservatorship or liquidation and gives reasons for that disagreement, the NCUA Board shall not place the credit union into conservatorship or liquidation unless it first considers the views of the appropriate State official and determines that—

(i) The NCUSIF faces a significant risk of loss if the credit union is not placed into conservatorship or liquidation; and

(ii) Conservatorship or liquidation is necessary either to reduce the risk of loss, or to reduce the expected loss, to the NCUSIF with respect to the credit union.

(b) *Nondelegation.* The NCUA Board may not delegate any determination under paragraph (a)(3) of this section.

(c) *Consultation on proposed discretionary action.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before taking any discretionary supervisory action under §§ 702.202(b), 702.203(b), 702.204(b), 702.304(b) and 702.305(b) with respect to a federally-insured State-chartered credit union; shall provide prompt notice of its decision to the appropriate State official; and shall allow the appropriate State official to take the proposed action independently or jointly with NCUA.

§ 702.206 Net worth restoration plans.

(a) *Schedule for filing*—(1) *Generally.* A federally-insured credit union shall file a written net worth restoration plan (NWRP) with the appropriate Regional Director and, if State-chartered, the appropriate State official, within 45 calendar days of the effective date of classification as either "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," unless the NCUA Board notifies the credit union in writing that its NWRP is to be filed within a different period.

(2) *Exception.* An otherwise "adequately capitalized" credit union that is reclassified "undercapitalized" on safety and soundness grounds under § 702.102(b) is not required to submit a NWRP solely due to the reclassification, unless the NCUA Board notifies the credit union that it must submit an NWRP.

(3) *Filing of additional plan.* Notwithstanding paragraph (a)(1) of this section, a credit union that has already submitted and is operating under a NWRP approved under this section is not required to submit an additional NWRP due to a change in net worth category (including by reclassification under § 702.102(b)), unless the NCUA Board notifies the credit union that it must submit a new NWRP. A credit union that is notified to submit a new or revised NWRP shall file the NWRP in writing with the appropriate Regional Director within 30 calendar days of receiving such notice, unless the NCUA Board notifies the credit union in writing that the NWRP is to be filed within a different period.

(4) *Failure to timely file plan.* When a credit union fails to timely file an NWRP pursuant to this paragraph, the NCUA Board shall promptly notify the credit union that it has failed to file an NWRP and that it has 15 calendar days from receipt of that notice within which to file an NWRP.

(b) *Assistance to small credit unions.* Upon timely request by a credit union having total assets of less than $10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing an NWRP required to be filed under paragraph (a) of this section.

(c) *Contents of NWRP.* An NWRP must—

(1) Specify—

(i) A quarterly timetable of steps the credit union will take to increase its net worth ratio so that it becomes "adequately capitalized" by the end of the term of the NWRP, and to remain so for four (4) consecutive calendar quarters. If "complex," the credit union is subject to a risk-based net worth requirement that may require a net worth ratio higher than six percent (6%) to become "adequately capitalized";

(ii) The projected amount of earnings to be transferred to the regular reserve account in each quarter of the term of the NWRP as required under § 702.201(a), or as permitted under § 702.201(b);

(iii) How the credit union will comply with the mandatory and any discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(iv) The types and levels of activities in which the credit union will engage; and

(v) If reclassified to a lower category under § 702.102(b), the steps the credit union will take to correct the unsafe or unsound practice(s) or condition(s);

(2) Include pro forma financial statements, including any off-balance sheet items, covering a minimum of the next two years; and

(3) Contain such other information as the NCUA Board has required.

(d) *Criteria for approval of NWRP.* The NCUA Board shall not accept a NWRP plan unless it—

(1) Complies with paragraph (c) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in restoring the credit union's net worth; and (3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(e) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become "adequately capitalized," the NCUA Board shall, in evaluating an NWRP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by State law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(f) *Review of NWRP*—(1) *Notice of decision.* Within 45 calendar days after receiving an NWRP under this part, the NCUA Board shall notify the credit union in writing whether the NWRP has been approved, and shall provide reasons for its decision in the event of disapproval.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (f)(1) of this section, the NWRP is deemed approved.

(3) *Consultation with State officials.* In the case of an NWRP submitted by a federally-insured State-chartered credit union (whether an original, new, additional, revised or amended NWRP), the NCUA Board shall, when evaluating the NWRP, seek and consider the views of the appropriate State official, and provide prompt notice of its decision to the appropriate State official.

(g) *NWRP not approved* (1) *Submission of revised NWRP.* If an NWRP is rejected by the NCUA Board, the credit union shall submit a revised NWRP within 30 calendar days of receiving notice of disapproval, unless it is notified in writing by the NCUA Board that the revised NWRP is to be filed within a different period.

(2) *Notice of decision on revised NWRP.* Within 30 calendar days after receiving a revised NWRP under paragraph (g)(1) of this section, the NCUA Board shall notify the credit union in writing whether the revised NWRP is approved. The Board may extend the time within which notice of its decision shall be provided.

(3) *Disapproval of reclassified credit union's NWRP.* A credit union which has been classified "significantly undercapitalized" under § 702.102(a)(4)(ii) shall remain so classified pending NCUA Board approval of a new or revised NWRP.

(h) *Amendment of NWRP.* A credit union that is operating under an approved NWRP may, after prior written notice to, and approval by the NCUA Board, amend its NWRP to reflect a change in circumstance. Pending approval of an amended NWRP, the credit union shall implement the NWRP as originally approved.

(i) *Publication.* An NWRP need not be published to be enforceable because publication would be contrary to the public interest.

Subpart C—Alternative Prompt Corrective Action for New Credit Unions

§ 702.301 Scope and definition.

(a) *Scope.* This subpart C applies in lieu of subpart B of this part exclusively to credit unions defined in paragraph (b) of this section as "new" pursuant to 12 U.S.C. 1790d(b)(2).

(b) *New credit union defined.* A "new" credit union for purposes of this subpart is a federally-insured credit union that both has been in operation for less than ten (10) years and has total assets of not more than $10 million. A credit union which exceeds $10 million in total assets may become "new" if its total assets subsequently decline below $10 million while it is still in operation for less than 10 years.

(c) *Effect of spin-offs.* A credit union formed as the result of a "spin-off" of a group from the field of membership of an existing credit union is deemed to be in operation since the effective date of the "spin-off." A credit union whose total assets decline below $10 million because a group within its field of membership has been "spun-off" is deemed "new" if it has been in operation less than 10 years.

(d) *Actions to evade prompt corrective action.* If the NCUA Board determines that a credit union was formed, or was reduced in asset size as a result of a "spin-off," or was merged, primarily to qualify as "new" under this subpart, the credit union shall be deemed subject to prompt corrective action under subpart A of this part.

§ 702.302 Net worth categories for new credit unions.

(a) *Net worth measures.* For purposes of this part, a new credit union must determine its net worth category classification quarterly according to its net worth ratio as defined in § 702.2(g).

(b) *Effective date of net worth classification of new credit union.* For purposes of subpart C, the effective date of a new federally-insured credit union's classification within a net worth category in paragraph (c) of this section shall be determined as provided in § 702.101(b); and written notice to the NCUA Board of a decline in net worth category in paragraph (c) of this section shall be given as required by section 702.101(c).

(c) *Net worth categories.* A federally-insured credit union defined as "new" under this section shall be classified (Table 6)—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%);

(3) *Moderately capitalized* if it has a net worth ratio of three and one-half percent (3.5%) or more but less than six percent (6%);

(4) *Marginally capitalized* if it has a net worth ratio of two percent (2%) or more but less than three and one-half percent (3.5%);

(5) *Minimally capitalized* if it has a net worth ratio of zero percent (0%) or greater but less than two percent (2%); and

(6) *Uncapitalized* if it has a net worth ratio of less than zero percent (0%) (*e.g.,* a deficit in retained earnings).

TABLE 6 -- NET WORTH CATEGORY CLASSIFICATION FOR "NEW" CREDIT UNIONS

A "new" credit union's net worth category is . . .	*if its net worth ratio is . . .*
"Well Capitalized"	7% or above
"Adequately Capitalized"	6% to 6.99%
"Moderately Capitalized"	3.5% to 5.99%
"Marginally Capitalized"	2% to 3.49%
"Minimally Capitalized"	0% to 1.99%
"Uncapitalized"	Less than 0%

(d) *Reclassification based on supervisory criteria other than net worth.* Subject to § 702.102(b) and (c), the NCUA Board may reclassify a "well capitalized," "adequately capitalized" or "moderately capitalized" new credit union to the next lower net worth category (each of such actions is hereinafter referred to generally as "reclassification") in either of the circumstances prescribed in § 702.102(b).

(e) *Consultation with State officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before reclassifying a federally-insured State-chartered credit union under paragraph (d) of this section, and shall promptly notify the appropriate State official of its decision to reclassify.

§ 702.303 Prompt corrective action for "adequately capitalized" new credit unions.

Beginning on the effective date of classification, an "adequately capitalized" new credit union must increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan in accordance with § 702.304(a)(2), or in the absence of such a plan, in accordance with § 702.201, and quarterly transfer that amount from undivided earnings to its regular reserve account, until it is "well capitalized."

§ 702.304 Prompt corrective action for "moderately capitalized," "marginally capitalized" or "minimally capitalized" new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the date of classification as "moderately capitalized," "marginally capitalized" or "minimally capitalized" (including by reclassification under § 702.302(d)), a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan and quarterly transfer that amount from undivided earnings to its regular reserve account;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.306 if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in § 702.204(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board may place a new credit union which is "moderately capitalized," "marginally capitalized" or "minimally capitalized" (including by reclassification under § 702.302(d)) into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming "adequately capitalized."

§ 702.305 Prompt corrective action for "uncapitalized" new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the effective date of classification as "uncapitalized," a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in the credit union's approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.306, providing for alternative means of funding the credit union's earnings deficit, if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans as provided in § 702.304(a)(3).

(b) *Discretionary supervisory actions by NCUA.* Subject to the procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in § 702.204(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Mandatory liquidation or conservatorship.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board—

(1) *Plan not submitted.* May place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an "uncapitalized" new credit union which fails to submit a revised business plan within the time provided under paragraph (a)(2) of this section; or

(2) *Plan rejected, approved, implemented.* Except as provided in paragraph (c)(3) of this section, must place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an "uncapitalized" new credit union that remains "uncapitalized" one hundred twenty (120) calendar days after the later of:

(i) The effective date of classification as "uncapitalized"; or

(ii) The last day of the calendar month following expiration of the time period provided in the credit union's initial business plan (approved at the time its charter was granted) to remain "uncapitalized," regardless whether a revised business plan was rejected, approved or implemented.

(3) *Exception.* The NCUA Board may decline to place a new credit union into liquidation or conservatorship as provided in paragraph (c)(2) of this section if the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming "adequately capitalized."

(d) *Mandatory liquidation of "uncapitalized" federal credit union.* In lieu of paragraph (c) of this section, an "uncapitalized" federal credit union may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

§ 702.306 Revised business plans for new credit unions.

(a) *Schedule for filing.* (1) *Generally.* Except as provided in paragraph (a)(2) of this section, a new credit union classified "moderately capitalized" or lower must file a written revised business plan (RBP) with the appropriate Regional Director and, if State-chartered, with the appropriate State official, within 30 calendar days of either:

(i) The last of the calendar month following the end of the calendar quarter that the credit union's net worth ratio has not increased consistent with its the-present approved business plan;

(ii) The effective date of classification as less than "adequately capitalized" if the credit union has no then-present approved business plan; or

(iii) The effective date of classification as less than "adequately capitalized" if the credit union has increased the total amount of member business loans in violation of § 702.304(a)(3).

(2) *Exception.* The NCUA Board may notify the credit union in writing that its RBP is to be filed within a different period or that it is not necessary to file an RBP.

(3) *Failure to timely file plan.* When a new credit union fails to file an RBP as provided under paragraphs (a)(1) or (a)(2) of this section, the NCUA Board shall promptly notify the credit union that it has failed to file an RBP and that it has 15 calendar days from receipt of that notice within which to do so.

(b) *Contents of revised business plan.* A new credit union's RBP must, at a minimum—

(1) Address changes, since the new credit union's current business plan was approved, in any of the business plan elements required for charter approval under Chapter 1, section IV.D. of NCUA's *Chartering and Field of Membership Manual* (IRPS 99–1), 63 FR 71998, 72019 (Dec. 30, 1998), or its successor(s), or for State-chartered credit unions under applicable State law;

(2) Establish a timetable of quarterly targets for net worth during each year in which the

RBP is in effect so that the credit union becomes "adequately capitalized" by the time it no longer qualifies as "new" per § 702.301(b);

(3) Specify the projected amount of earnings to be transferred quarterly to its regular reserve as provided under § 702.304(a)(1) or 702.305(a)(1);

(4) Explain how the new credit union will comply with the mandatory and discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(5) Specify the types and levels of activities in which the new credit union will engage;

(6) In the case of a new credit union reclassified to a lower category under § 702.302(d), specify the steps the credit union will take to correct the unsafe or unsound condition or practice; and

(7) Include such other information as the NCUA Board may require.

(c) *Criteria for approval.* The NCUA Board shall not approve a new credit union's RBP unless it—

(1) Addresses the items enumerated in paragraph (b) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in building the credit union's net worth; and

(3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(d) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become "adequately capitalized," the NCUA Board shall, in evaluating an RBP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by State law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(e) *Review of revised business plan*— (1) *Notice of decision.* Within 30 calendar days after receiving an RBP under this section, the NCUA Board shall notify the credit union in writing whether its RBP is approved, and shall provide reasons for its decision in the event of disapproval. The NCUA Board may extend the time within which notice of its decision shall be provided.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (e)(1) of this section, the RBP is deemed approved.

(3) *Consultation with State officials.* When evaluating an RBP submitted by a federally-insured State-chartered new credit union (whether an original, new or additional RBP), the NCUA Board shall seek and consider the views of the appropriate State official, and provide prompt notice of its decision to the appropriate State official.

(f) *Plan not approved*—(1) *Submission of new revised plan.* If an RBP is rejected by the NCUA Board, the new credit union shall submit a new RBP within 30 calendar days of receiving notice of disapproval of its initial RBP, unless it is notified in writing by the NCUA Board that the new RBP is to be filed within a different period.

(2) *Notice of decision on revised plan.* Within 30 calendar days after receiving an RBP under paragraph (f)(1) of this section, the NCUA Board shall notify the credit union in writing whether the new RBP is approved. The Board may extend the time within which notice of its decision shall be provided.

(g) *Amendment of plan.* A credit union that has filed an approved RBP may, after prior written notice to and approval by the NCUA Board, amend it to reflect a change in circumstance. Pending approval of an amended RBP, the new credit union shall implement its existing RBP as originally approved.

(h) *Publication.* An RBP need not be published to be enforceable because publication would be contrary to the public interest.

§ 702.307 Incentives for new credit unions.

(a) *Assistance in revising business plans.* Upon timely request by a credit union having total assets of less than $10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing a revised business plan required to be filed under § 702.306.

(b) *Assistance.* Management training and other assistance to new credit unions will be provided in accordance with policies approved by the NCUA Board.

(c) *Small credit union program.* A new credit union is eligible to join and receive comprehensive benefits and assistance under NCUA's Small Credit Union Program.

Subpart D—Reserves

§ 702.401 Reserves.

(a) *Special reserve.* Each federally-insured credit union shall establish and maintain such reserves as may be required by the FCUA, by state law,

by regulation, or in special cases by the NCUA Board or appropriate State official.

(b) *Regular reserve.* Each federally-insured credit union shall establish and maintain a regular reserve account for the purpose of absorbing losses that exceed undivided earnings and other appropriations of undivided earnings, subject to paragraph (c) of this section. Earnings required to be transferred annually to a credit union's regular reserve under subparts B or C of this part shall be held in this account.

(c) *Charges to regular reserve after depleting undivided earnings.* The board of directors of a federally-insured credit union may authorize losses to be charged to the regular reserve after first depleting the balance of the undivided earnings account and other reserves, provided that the authorization states the amount and provides an explanation of the need for the charge, and either—

(1) The charge will not cause the credit union's net worth classification to fall below "adequately capitalized" under subparts B or C of this part; or

(2) If the charge will cause the net worth classification to fall below "adequately capitalized," the appropriate Regional Director and, if State-chartered, the appropriate State official, have given written approval (in an NWRP or otherwise) for the charge.

(d) *Transfers to regular reserve.* The transfer of earnings to a federally-insured credit union's regular reserve account when required under subparts B or C of this part must occur after charges for loan or other losses are addressed as provided in paragraph (c) of this section and § 702.402(d), but before payment of any dividends to members.

§ 702.402 Full and fair disclosure of financial condition.

(a) *Full and fair disclosure defined.* "Full and fair disclosure" is the level of disclosure which a prudent person would provide to a member of a federally-insured credit union, to NCUA, or, at the discretion of the board of directors, to creditors to fairly inform them of the financial condition and the results of operations of the credit union.

(b) *Full and fair disclosure implemented.* The financial statements of a federally-insured credit union shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation (allowance) accounts as may be necessary to present fairly the financial condition; and all income and expenses necessary to present fairly the statement of income for the reporting period.

(c) *Declaration of officials.* The Statement of Financial Condition, when presented to members, to creditors or to the NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, by any other officer designated by the board of directors of the reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial condition and the statement of income for the period covered.

(d) *Charges for loan losses.* Full and fair disclosure demands that a credit union properly address charges for loan losses as follows:

(1) Charges for loan losses shall be made in accordance with generally accepted accounting principles (GAAP);

(2) The allowance for loan and lease losses (ALL) established for loans must fairly present the probable losses for all categories of loans and the proper valuation of loans. The valuation allowance must encompass specifically identified loans, as well as estimated losses inherent in the loan portfolio, such as loans and pools of loans for which losses have been incurred but are not identifiable on a specific loan-by-loan basis;

(3) Adjustments to the valuation ALL will be recorded in the expense account "Provision for Loan and Lease Losses";

(4) The maintenance of an ALL shall not affect the requirement to transfer earnings to a credit union's regular reserve when required under subparts B or C of this part; and

(5) At a minimum, adjustments to the ALL shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.403 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from undivided earnings, if any.

(b) *Payment of dividends if undivided earnings depleted.* The board of directors of a "well capitalized" federally-insured credit union that has depleted the balance of its undivided earnings account may authorize a transfer of funds from the credit union's regular reserve account to undivided earnings to pay dividends, provided that either—

(1) The payment of dividends will not cause the credit union's net worth classification to fall below "adequately capitalized" under subpart B or C of this part; or

(2) If the payment of dividends will cause the net worth classification to fall below "adequately capitalized," the appropriate Regional Director and, if State-chartered, the appropriate State official, have given prior written approval (in an NWRP or otherwise) to pay a dividend.

Part 703

Investment and Deposit Activities

§ 703.1 Purpose and scope.

(a) This part interprets several of the provisions of Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act (Act), 12 U.S.C. 1757(7), 1757(8), 1757(15), which list those securities, deposits, and other obligations in which a Federal credit union may invest. Part 703 identifies certain investments and deposit activities permissible under the Act and prescribes regulations governing those investments and deposit activities on the basis of safety and soundness concerns. Additionally, part 703 identifies and prohibits certain investments and deposit activities. Investments and deposit activities that are permissible under the Act and not prohibited or otherwise regulated by part 703 remain permissible for Federal credit unions.

(b) This part does not apply to:

(1) Investment in loans to members and related activities, which is governed by §§ 701.21, 701.22, 701.23, and part 723 of this chapter;

(2) The purchase of real estate-secured loans pursuant to Section 107(15)(A) of the Act, which is governed by § 701.23 of this chapter;

(3) Investment in credit union service organizations, which is governed by part 712 of this chapter;

(4) Investment in fixed assets, which is governed by § 701.36 of this chapter;

(5) Investment by corporate credit unions, which is governed by part 704 of this chapter; or

(6) Investment activity by State-chartered credit unions, except as provided in § 741.3(a)(3) and § 741.219 of this chapter.

§ 703.2 Definitions.

The following definitions apply to this part:

Adjusted trading means selling an investment to a counterparty at a price above its current fair value and simultaneously purchasing or committing to purchase from the counterparty another investment at a price above its current fair value.

Associated personnel means a person engaged in the investment banking or securities business who is directly or indirectly controlled by a National Association of Securities Dealers (NASD) member, whether or not this person is registered or exempt from registration with NASD. Associated personnel includes every sole proprietor, partner, officer, director, or branch manager of any NASD member.

Banker's acceptance means a time draft that is drawn on and accepted by a bank and that represents an irrevocable obligation of the bank.

Bank note means a direct, unconditional, and unsecured general obligation of a bank that ranks equally with all other senior unsecured indebtedness of the bank, except deposit liabilities and other obligations that are subject to any priorities or preferences.

Borrowing repurchase transaction means a transaction in which the Federal credit union agrees to sell a security to a counterparty and to repurchase the same or an identical security from that counterparty at a specified future date and at a specified price.

Call means an option that gives the holder the right to buy the underlying security at a specified price during a fixed time period.

Collective investment fund means a fund maintained by a national bank under 12 CFR part 9 (Comptroller of the Currency's regulations).

Commercial mortgage related security means a mortgage related security, as defined below, except that it is collateralized entirely by commercial real estate, such as a warehouse or office building, or a multi-family dwelling consisting of more than four units.

Counterparty means the party on the other side of the transaction.

Custodial agreement means a contract in which one party agrees to exercise ordinary care in protecting the securities held in safekeeping for others.

Delivery versus payment means payment for an investment must occur simultaneously with its delivery.

Deposit note means an obligation of a bank that is similar to a certificate of deposit but is rated.

Derivatives means financial instruments or other contracts whose value is based on the performance of an underlying financial asset, index or other investment that have the three following characteristics:

(1) It has one or more underlyings and one or more notional amounts or payment provisions or both that determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required;

(2) It requires no initial net investment or an initial net investment that is less than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(3) Its terms require or permit net settlement, it can readily be settled net by means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Embedded option means a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. Embedded options include call and put provisions and interest rate caps and floors. Since a prepayment option in a mortgage is a type of call provision, a mortgage-backed security composed of mortgages that may be prepaid is an example of an investment with an embedded option.

Eurodollar deposit means a U.S. dollar-denominated deposit in a foreign branch of a United States depository institution.

European financial options contract means an option that can be exercised only on its expiration date.

Fair value means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale.

Financial options contract means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract as specified in the agreement.

Immediate family member means a spouse or other family member living in the same household.

Industry-recognized information provider means an organization that obtains compensation by providing information to investors and receives no compensation for the purchase or sale of investments.

Investment means any security, obligation, account, deposit, or other item authorized for purchase by a Federal credit union under Sections 107(7), 107(8), or 107(15) of the Act, or this part, other than loans to members.

Investment repurchase transaction means a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price.

Maturity means the date the last principal amount of a security is scheduled to come due and does not mean the call date or the weighted average life of a security.

Mortgage related security means a security as defined in Section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), *e.g.*, a privately-issued security backed by first lien mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure, that is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization.

Mortgage servicing rights means a contractual obligation to perform mortgage servicing and the right to receive compensation for performing those services. Mortgage servicing is the administration of a mortgage loan, including collecting monthly payments and fees, providing recordkeeping and escrow functions, and, if necessary curing defaults and foreclosing.

Negotiable instrument means an instrument that may be freely transferred from the purchaser to another person or entity by delivery, or endorsement and delivery, with full legal title becoming vested in the transferee.

Net worth means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles and as further defined in § 702.2(f) of this chapter.

Official means any member of a Federal credit union's board of directors, credit committee, supervisory committee, or investment-related committee.

Ordinary care means the degree of care, which an ordinarily prudent and competent person engaged in the same line of business or endeavor should exercise under similar circumstances.

Pair-off transaction means an investment purchase transaction that is closed or sold on, or before the settlement date. In a pair-off, an investor commits to purchase an investment, but then pairs-off the purchase with a sale of the same investment before or on the settlement date.

Put means a financial options contract that entitles the holder to sell, entirely at the holder's op-

tion, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.

Registered investment company means an investment company that is registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a). Examples of registered investment companies are mutual funds and unit investment trusts.

Regular way settlement means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular way settlement of a Treasury security includes settlement on the trade date (cash), the business day following the trade date (regular way), and the second business day following the trade date (skip day).

Residual interest means the remainder cash flows from collateralized mortgage obligations/real estate mortgage investment conduits (CMOs/REMICs), or other mortgage-backed security transaction, after payments due bondholders and trust administrative expenses have been satisfied.

Securities lending means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

Security means a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:

(1) Either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;

(2) Is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(3) Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Senior management employee means a Federal credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), an assistant chief executive officer, and the chief financial officer.

Small business related security means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53), *e.g.*, a security that is rated in 1 of the 4 highest rating categories by at least one nationally recognized statistical rating organization, and represents an interest in one or more promissory notes or leases of personal property evidencing the obligation of a small business concern and originated by an insured depository institution, insured credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority, or a finance company or leasing company. This definition does not include Small Business Administration securities permissible under § 107(7) of the Act.

Weighted average life means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of principal.

When-issued trading of securities means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

Yankee dollar deposit means a deposit in a United States branch of a foreign bank licensed to do business in the State in which it is located, or a deposit in a State-chartered, foreign controlled bank.

Zero coupon investment means an investment that makes no periodic interest payments but instead is sold at a discount from its face value. The holder of a zero coupon investment realizes the rate of return through the gradual appreciation of the investment, which is redeemed at face value on a specified maturity date.

§ 703.3 Investment policies.

A Federal credit union's board of directors must establish written investment policies consistent with the Act, this part, and other applicable laws and regulations and must review the policy at least annually. These policies may be part of a broader, asset-liability management policy. Written investment policies must address the following:

(a) The purposes and objectives of the Federal credit union's investment activities;

(b) The characteristics of the investments the Federal credit union may make including the issuer, maturity, index, cap, floor, coupon rate, coupon formula, call provision, average life, and interest rate risk;

(c) How the Federal credit union will manage interest rate risk;

(d) How the Federal credit union will manage liquidity risk;

(e) How the Federal credit union will manage credit risk including specifically listing institutions, issuers, and counterparties that may be used, or criteria for their selection, and limits on the amounts that may be invested with each;

(f) How the Federal credit union will manage concentration risk, which can result from dealing with a single or related issuers, lack of geographic distribution, holding obligations with similar characteristics like maturities and indexes, holding bonds having the same trustee, and holding securitized loans having the same originator, packager, or guarantor;

(g) Who has investment authority and the extent of that authority. Those with authority must be qualified by education or experience to assess the risk characteristics of investments and investment transactions. Only officials or employees of the Federal credit union may be voting members of an investment-related committee;

(h) The broker-dealers the Federal credit union may use;

(i) The safekeepers the Federal credit union may use;

(j) How the Federal credit union will handle an investment that, after purchase, is outside of board policy or fails a requirement of this part; and

(k) How the Federal credit union will conduct investment trading activities, if applicable, including addressing:

(1) Who has purchase and sale authority;

(2) Limits on trading account size;

(3) Allocation of cash flow to trading accounts;

(4) Stop loss or sale provisions;

(5) Dollar size limitations of specific types, quantity and maturity to be purchased;

(6) Limits on the length of time an investment may be inventoried in a trading account; and

(7) Internal controls, including segregation of duties.

§ 703.4 Recordkeeping and documentation requirements.

(a) Federal credit unions with assets of $10,000,000 or greater must comply with all generally accepted accounting principles applicable to reports or statements required to be filed with NCUA. Federal credit unions with assets less than $10,000,000 are encouraged to do the same, but are not required to do so. Federal credit unions with assets less than $10,000,000 may choose to account for their investments consistent with the NCUA Accounting Manual For Federal Credit Unions.

(b) A Federal credit union must maintain documentation for each investment transaction for as long as it holds the investment and until the documentation has been audited in accordance with § 701.12 of this chapter and examined by NCUA. The documentation should include, where applicable, bids and prices at purchase and sale and for periodic updates, relevant disclosure documents or a description of the security from an industry-recognized information provider, financial data, and tests and reports required by the Federal credit union's investment policy and this part.

(c) A Federal credit union must maintain documentation its board of directors used to approve a broker-dealer or a safekeeper for as long as the broker-dealer or safekeeper is approved and until the documentation has been audited in accordance with § 701.12 of this chapter and examined by NCUA.

(d) A Federal credit union must obtain an individual confirmation statement from each broker-dealer for each investment purchased or sold.

§ 703.5 Discretionary control over investments and investment advisers.

(a) Except as provided in paragraph (b) of this section, a Federal credit union must retain discretionary control over its purchase and sale of investments. A Federal credit union has not delegated discretionary control to an investment adviser when the Federal credit union reviews all recommendations from investment advisers and is required to authorize a recommended purchase or sale transaction before its execution.

(b)(1) A Federal credit union may delegate discretionary control over the purchase and sale of investments to a person other than a Federal credit union official or employee:

(i) Provided the person is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (15 U.S.C. 80b); and

(ii) In an amount up to 100 percent of its net worth in the aggregate at the time of delegation.

(2) At least annually, the Federal credit union must adjust the amount of funds held under discretionary control to comply with the

100 percent of net worth cap. The Federal credit union's board of directors must receive notice as soon as possible, but no later than the next regularly scheduled board meeting, of the amount exceeding the net worth cap and notify in writing the appropriate regional director within 5 days after the board meeting. The credit union must develop a plan to comply with the cap within a reasonable period of time.

(3) Before transacting business with an investment adviser, a Federal credit union must analyze his or her background and information available from State or Federal securities regulators, including any enforcement actions against the adviser, associated personnel, and the firm for which the adviser works.

(c) A Federal credit union may not compensate an investment adviser with discretionary control over the purchase and sale of investments on a per transaction basis or based on capital gains, capital appreciation, net income, performance relative to an index, or any other incentive basis.

(d) A Federal credit union must obtain a report from its investment adviser at least monthly that details the investments under the adviser's control and their performance.

§ 703.6 Credit analysis.

A Federal credit union must conduct and document a credit analysis on an investment and the issuing entity before purchasing it, except for investments issued or fully guaranteed as to principal and interest by the U.S. government or its agencies, enterprises, or corporations or fully insured (including accumulated interest) by the National Credit Union Administration or the Federal Deposit Insurance Corporation. A Federal credit union must update this analysis at least annually for as long as it holds the investment.

§ 703.7 Notice of non-compliant investments.

A Federal credit union's board of directors must receive notice as soon as possible, but no later than the next regularly scheduled board meeting, of any investment that either is outside of board policy after purchase or has failed a requirement of this part. The board of directors must document its action regarding the investment in the minutes of the board meeting, including a detailed explanation of any decision not to sell it. The Federal credit union must notify in writing the appropriate regional director of an investment that has failed a requirement of this part within 5 days after the board meeting.

§ 703.8 Broker-dealers.

(a) A Federal credit union may purchase and sell investments through a broker-dealer as long as the broker-dealer is registered as a broker-dealer with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or is a depository institution whose broker-dealer activities are regulated by a Federal or State regulatory agency.

(b) Before purchasing an investment through a broker-dealer, a Federal credit union must analyze and annually update the following:

(1) The background of any sales representative with whom the Federal credit union is doing business;

(2) Information available from State or Federal securities regulators and securities industry self-regulatory organizations, such as the National Association of Securities Dealers and the North American Securities Administrators Association, about any enforcement actions against the broker-dealer, its affiliates, or associated personnel; and

(3) If the broker-dealer is acting as the Federal credit union's counterparty, the ability of the broker-dealer and its subsidiaries or affiliates to fulfill commitments, as evidenced by capital strength, liquidity, and operating results. The Federal credit union should consider current financial data, annual reports, reports of nationally-recognized statistical rating agencies, relevant disclosure documents, and other sources of financial information.

(c) The requirements of paragraph (a) of this section do not apply when the Federal credit union purchases a certificate of deposit or share certificate directly from a bank, credit union, or other depository institution.

§ 703.9 Safekeeping of investments.

(a) A Federal credit union's purchased investments and repurchase collateral must be in the Federal credit union's possession, recorded as owned by the Federal credit union through the Federal Reserve Book-Entry System, or held by a board-approved safekeeper under a written custodial agreement that requires the safekeeper to exercise, at least, ordinary care.

(b) Any safekeeper used by a Federal credit union must be regulated and supervised by either the Securities and Exchange Commission, a Federal or State depository institution regulatory agency, or a State trust company regulatory agency.

(c) A Federal credit union must obtain and reconcile monthly a statement of purchased investments and repurchase collateral held in safekeeping.

(d) Annually, the Federal credit union must analyze the ability of the safekeeper to fulfill its custodial responsibilities, as evidenced by capital strength, liquidity, and operating results. The Federal credit union should consider current financial data, annual reports, reports of nationally-recognized statistical rating agencies, relevant disclosure documents, and other sources of financial information.

§ 703.10 Monitoring non-security investments.

(a) At least quarterly, a Federal credit union must prepare a written report listing all of its shares and deposits in banks, credit unions, and other depository institutions, that have one or more of the following features:

(1) Embedded options;

(2) Remaining maturities greater than 3 years; or

(3) Coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.

(b) The requirement of paragraph (a) of this section does not apply to shares and deposits that are securities.

(c) If a Federal credit union does not have an investment-related committee, then each member of its board of directors must receive a copy of the report described in paragraph (a) of this section. If a Federal credit union has an investment-related committee, then each member of the committee must receive a copy of the report, and each member of the board must receive a summary of the information in the report.

§ 703.11 Valuing securities.

(a) Before purchasing or selling a security, a Federal credit union must obtain either price quotations on the security from at least two broker-dealers or a price quotation on the security from an industry-recognized information provider. This requirement to obtain price quotations does not apply to new issues purchased at par or at original issue discount.

(b) At least monthly, a Federal credit union must determine the fair value of each security it holds. It may determine fair value by obtaining a price quotation on the security from an industry-recognized information provider, a broker-dealer, or a safekeeper.

(c) At least annually, the Federal credit union's supervisory committee or its external auditor must independently assess the reliability of monthly price quotations received from a broker-dealer or safekeeper. The Federal credit union's supervisory committee or external auditor must follow generally accepted auditing standards, which require either re-computation or reference to market quotations.

(d) If a Federal credit union is unable to obtain a price quotation required by this section for a particular security, then it may obtain a quotation for a security with substantially similar characteristics.

§ 703.12 Monitoring securities.

(a) At least monthly, a Federal credit union must prepare a written report setting forth, for each security held, the fair value and dollar change since the prior month-end, with summary information for the entire portfolio.

(b) At least quarterly, a Federal credit union must prepare a written report setting forth the sum of the fair values of all fixed and variable rate securities held that have one or more of the following features:

(1) Embedded options;

(2) Remaining maturities greater than 3 years; or

(3) Coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.

(c) Where the amount calculated in paragraph (b) of this section is greater than a Federal credit union's net worth, the report described in that paragraph must provide a reasonable and supportable estimate of the potential impact, in percentage and dollar terms, of an immediate and sustained parallel shift in market interest rates of plus and minus 300 basis points on:

(1) The fair value of each security in the Federal credit union's portfolio;

(2) The fair value of the Federal credit union's portfolio as a whole; and

(3) The Federal credit union's net worth.

(d) If the Federal credit union does not have an investment-related committee, then each member of its board of directors must receive a copy of the reports described in paragraphs (a) through (c) of this section. If the Federal credit union has an investment-related committee, then each member of the committee must receive copies of the reports, and each member of the board of directors must receive a summary of the information in the reports.

§ 703.13 Permissible investment activities.

(a) *Regular way settlement and delivery versus payment basis.* A Federal credit union may only contract for the purchase or sale of a security as long as the delivery of the security is by regular way settlement and the transaction is accomplished on a delivery versus payment basis.

(b) *Federal funds.* A Federal credit union may sell Federal funds to an institution described in Section 107(8) of the Act and credit unions, as long as the interest or other consideration received from the financial institution is at the market rate for Federal funds transactions.

(c) *Investment repurchase transaction.* A Federal credit union may enter into an investment repurchase transaction so long as:

(1) Any securities the Federal credit union receives are permissible investments for Federal credit unions, the Federal credit union, or its agent, either takes physical possession or control of the repurchase securities or is recorded as owner of them through the Federal Reserve Book Entry Securities Transfer System, the Federal credit union, or its agent, receives a daily assessment of their market value, including accrued interest, and the Federal credit union maintains adequate margins that reflect a risk assessment of the securities and the term of the transaction; and

(2) The Federal credit union has entered into signed contracts with all approved counterparties.

(d) *Borrowing repurchase transaction.* A Federal credit union may enter into a borrowing repurchase transaction so long as:

(1) The transaction meets the requirements of paragraph (c) of this section;

(2) Any cash the Federal credit union receives is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments the Federal credit union purchases with that cash are permissible for Federal credit unions; and

(3) The investments referenced in paragraph (d)(2) of this section mature no later than the maturity of the borrowing repurchase transaction.

(e) *Securities lending transaction.* A Federal credit union may enter into a securities lending transaction so long as:

(1) The Federal credit union receives written confirmation of the loan;

(2) Any collateral the Federal credit union receives is a legal investment for Federal credit unions, the Federal credit union, or its agent, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book Entry Securities Transfer System; and the Federal credit union, or its agent, receives a daily assessment of the market value of the collateral, including accrued interest, and maintains adequate margin that reflects a risk assessment of the collateral and the term of the loan;

(3) Any cash the Federal credit union receives is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments the Federal credit union purchases with that cash are permissible for Federal credit unions and mature no later than the maturity of the transaction; and

(4) The Federal credit union has executed a written loan and security agreement with the borrower.

(f)(1) *Trading securities.* A Federal credit union may trade securities, including engaging in when-issued trading and pair-off transactions, so long as the Federal credit union can show that it has sufficient resources, knowledge, systems, and procedures to handle the risks.

(2) A Federal credit union must record any security it purchases or sells for trading purposes at fair value on the trade date. The trade date is the date the Federal credit union commits, orally or in writing, to purchase or sell a security.

(3) At least monthly, the Federal credit union must give its board of directors or investment-related committee a written report listing all purchase and sale transactions of trading securities and the resulting gain or loss on an individual basis.

§ 703.14 Permissible investments.

(a) *Variable rate investment.* A Federal credit union may invest in a variable rate investment, as long as the index is tied to domestic interest rates and not, for example, to foreign currencies, foreign interest rates, or domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this part, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

(b) *Corporate credit union shares or deposits.* A Federal credit union may purchase shares or deposits in a corporate credit union, except where the NCUA Board has notified it that the corporate credit union is not operating in compliance with part 704 of this chapter. A Federal credit union's aggregate amount of paid-in capital and membership capital, as defined in part 704 of this chapter, in one corporate credit union is limited to two percent of its assets measured at the time of investment or adjustment. A Federal credit union's aggregate amount of paid-in capital and membership capital in all corporate credit unions is limited to four percent of its assets measured at the time of investment or adjustment.

(c) *Registered investment company.* A Federal credit union may invest in a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for Federal credit unions.

(d) *Collateralized mortgage obligation/real estate mortgage investment conduit.* A Federal credit union may invest in a fixed or variable rate collateralized mortgage obligation/real estate mortgage investment conduit.

(e) *Municipal security.* A Federal credit union may purchase and hold a municipal security, as defined in Section 107(7)(K) of the Act, only if a nationally-recognized statistical rating organization has rated it in one of the four highest rating categories.

(f) *Instruments issued by institutions described in Section 107(8) of the Act.* A Federal credit union may invest in the following instruments issued by an institution described in Section 107(8) of the Act:

(1) Yankee dollar deposits;

(2) Eurodollar deposits;

(3) Banker's acceptances;

(4) Deposit notes; and

(5) Bank notes with original weighted average maturities of less than 5 years.

(g) *European financial options contract.* A Federal credit union may purchase a European financial options contract or a series of European financial options contracts only to fund the payment of dividends on member share certificates where the dividend rate is tied to an equity index provided:

(1) The option and dividend rate are based on a domestic equity index;

(2) Proceeds from the options are used only to fund dividends on the equity-linked share certificates;

(3) Dividends on the share certificates are derived solely from the change in the domestic equity index over a specified period;

(4) The options' expiration dates coincide with the maturity date of the share certificate;

(5) The certificate may be redeemed prior to the maturity date only upon the member's death or termination of the corresponding option;

(6) The total costs associated with the purchase of the option is known by the Federal credit union prior to effecting the transaction;

(7) The options are purchased at the same time the certificate is issued to the member.

(8) The counterparty to the transaction is a domestic counterparty and has been approved by the Federal credit union's board of directors;

(9) The counterparty to the transaction:

(i) Has a long-term, senior, unsecured debt rating from a nationally-recognized statistical rating organization of AA- (or equivalent) or better at the time of the transaction, and the contract between the counterparty and the Federal credit union specifies that if the long-term, senior, unsecured debt rating declines below AA- (or equivalent) then the counterparty agrees to post collateral with an independent party in an amount fully securing the value of the option; or

(ii) Posts collateral with an independent party in an amount fully securing the value of the option if the counterparty does not have a long-term, senior unsecured debt rating from a nationally-recognized statistical rating organization.

(10) Any collateral posted by the counterparty is a permissible investment for Federal credit unions and is valued daily by an independent third party along with the value of the option;

(11) The aggregate amount of equity-linked member share certificates does not exceed the credit union's net worth;

(12) The terms of the share certificate include a guarantee that there can be no loss of principal to the member regardless of changes in the value of the option unless the certificate is redeemed prior to maturity; and

(13) The Federal credit union provides its board of directors with a monthly report detailing at a minimum:

(i) The dollar amount of outstanding equity-linked share certificates;

(ii) Their maturities; and

(iii) The fair value of the options as determined by an independent third party.

§ 703.15 Prohibited investment activities.

Adjusted trading or short sales. A Federal credit union may not engage in adjusted trading or short sales.

§ 703.16 Prohibited investments.

(a) *Derivatives.* A Federal credit union may not purchase or sell financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements, except as permitted under §§ 701.21(i) and 703.14(g) of this chapter;

(b) *Zero coupon investments.* A Federal credit union may not purchase a zero coupon investment with a maturity date that is more than 10 years from the settlement date;

(c) *Mortgage servicing rights.* A Federal credit union may not purchase mortgage servicing rights as an investment but may perform mortgage servicing functions as a financial service for a member as long as the mortgage loan is owned by a member;

(d) A Federal credit union may not purchase a commercial mortgage related security that is not otherwise permitted by Section 107(7)(E) of the Act; and

(e) *Other prohibited investments.* A Federal credit union may not purchase stripped mortgage-backed securities, residual interests in collateralized mortgage obligations/real estate mortgage investment conduits, or small business related securities.

§ 703.17 Conflicts of interest.

(a) A Federal credit union's officials and senior management employees, and their immediate family members, may not receive anything of value in connection with its investment transactions. This prohibition also applies to any other employee, such as an investment officer, if the employee is directly involved in investments, unless the Federal credit union's board of directors determines that the employee's involvement does not present a conflict of interest. This prohibition does not include compensation for employees.

(b) A Federal credit union's officials and employees must conduct all transactions with business associates or family members that are not specifically prohibited by paragraph (a) of this section at arm's length and in the Federal credit union's best interest.

§ 703.18 Grandfathered investments.

(a) Subject to safety and soundness considerations, a Federal credit union may hold a CMO/REMIC residual, stripped mortgage-backed securities, or zero coupon security with a maturity greater than 10 years, if it purchased the investment:

(1) Before December 2, 1991; or

(2) On or after December 2, 1991, but before January 1, 1998, if for the purpose of reducing interest rate risk and if the Federal credit union meets the following:

(i) The Federal credit union has a monitoring and reporting system in place that provides the documentation necessary to evaluate the expected and actual performance of the investment under different interest rate scenarios;

(ii) The Federal credit union uses the monitoring and reporting system to conduct and document an analysis that shows, before purchase, that the proposed investment will reduce its interest rate risk;

(iii) After purchase, the Federal credit union evaluates the investment at least quarterly to determine whether or not it actually has reduced the interest rate risk; and

(iv) The Federal credit union accounts for the investment consistent with generally accepted accounting principles.

(b) All grandfathered investments are subject to the valuation and monitoring requirements of §§ 703.10, 703.11, and 703.12 of this part.

§ 703.19 Investment pilot program.

(a) Under the investment pilot program, NCUA will permit a limited number of Federal credit unions to engage in investment activities prohibited by this part but permitted by the Act.

(b) Except as provided in paragraph (c) of this section, before a Federal credit union may engage in additional activities it must obtain written approval from NCUA. To obtain approval, a Federal credit union must submit a request to its regional director that addresses the following items:

(1) Certification that the Federal credit union is "well-capitalized" under part 702 of this chapter;

(2) Board policies approving the activities and establishing limits on them;

(3) A complete description of the activities, with specific examples of how they will benefit the Federal credit union and how they will be conducted;

(4) A demonstration of how the activities will affect the Federal credit union's financial performance, risk profile, and asset-liability management strategies;

(5) Examples of reports the Federal credit union will generate to monitor the activities;

(6) Projections of the associated costs of the activities, including personnel, computer, audit, and so forth;

(7) Descriptions of the internal systems that will measure, monitor, and report the activities;

(8) Qualifications of the staff and officials responsible for implementing and overseeing the activities; and

(9) Internal control procedures that will be implemented, including audit requirements.

(c) A third-party seeking approval of an investment pilot program must submit a request to the Director of the Office of Examination and Insurance that addresses the following items:

(1) A complete description of the activities with specific examples of how a credit union will conduct and account for them, and how they will benefit a Federal credit union;

(2) A description of any risks to a Federal credit union from participating in the program; and

(3) Contracts that must be executed by the Federal credit union.

(d) A Federal credit union need not obtain individual written approval to engage in investment activities prohibited by this part but permitted by statute where the activities are part of a third-party investment program that NCUA has approved under this section.

Part 704

Corporate Credit Unions

§ 704.1 Scope.

(a) This part establishes special rules for all federally insured corporate credit unions. Non federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The Board has the authority to issue orders which vary from this part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). Requests by state-chartered corporate credit unions for waivers to this part and for expansions of authority under Appendix B of this part must be approved by the state regulator before being submitted to NCUA.

§ 704.2 Definitions.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security (ABS) means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the securityholders. This definition excludes mortgage related securities.

Capital means the sum of a corporate credit union's retained earnings, paid-in capital, and membership capital.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized mortgage obligation (CMO) means a multi-class mortgage-related security.

Core capital means the corporate credit union's retained earnings and paid-in capital.

Core capital ratio means the corporate credit union's core capital divided by its moving daily average net assets.

Corporate credit union means an organization that:

(1) Is chartered under Federal or state law as a credit union;

(2) Receives shares from and provides loan services to credit unions;

(3) Is operated primarily for the purpose of serving other credit unions;

(4) Is designated by NCUA as a corporate credit union;

(5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and

(6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Daily average net assets means the average of net assets calculated for each day during the period.

Dollar roll means the purchase or sale of a mortgage backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

Fair value means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value. If a quoted market price in an active

market is not available, fair value may be estimated using a valuation technique that is reasonable and supportable, a quoted market price in an active market for a similar instrument, or a current appraised value. Examples of valuation techniques include the present value of estimated future cash flows, option-pricing models, and option-adjusted spread models. Valuation techniques should incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility.

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Forward settlement of a transaction means settlement on a date later than regular-way settlement.

Immediate family member means a spouse or other family member living in the same household.

Limited liquidity investment means a private placement or funding agreement.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Membership capital means funds contributed by members that: are adjustable balance with a minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years; are available to cover losses that exceed retained earnings and paid-in capital; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Mortgage related security means a security as defined in section 3(a)(41) of the Securities Exchange Act of 1934,15 U.S.C. 78c(a)(41), *e.g.*, a privately-issued security backed by mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

Moving daily average net assets means the average of daily average net assets for the month being measured and the previous 11 months.

NCUA means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions. For its own account, a corporate credit union's payables under reverse repurchase agreements and receivables under repurchase agreements may be netted out if the Generally Accepted Accounting Principles (GAAP) conditions for offsetting are met.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options. The amortized portion of membership capital and paid-in capital, which do not qualify as capital, are treated as liabilities for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Obligor means the primary party obligated to repay an investment, *e.g.*, the issuer of a security, the taker of a deposit, or the borrower of funds in a federal funds transaction. Obligor does not include an originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment.

Official means any director or committee member.

Paid-in capital means accounts or other interests of a corporate credit union that: are perpetual, non-cumulative dividend accounts; are available to cover losses that exceed retained earnings; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Quoted market price means a recent sales price or a price based on current bid and asked quotations.

Regular-way settlement means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular-way settlement of a Treas-

ury security includes settlement on the trade date ("cash"), the business day following the trade date ("regular way"), and the second business day following the trade date ("skip day").

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a specified future date and at a specified price.

Residual interest means the remainder cash flows from a CMO or ABS transaction after payments due bondholders and trust administrative expenses have been satisfied.

Retained earnings means the total of the corporate credit union's undivided earnings, reserves, and any other appropriations designated by management or regulatory authorities. For purposes of this regulation, retained earnings does not include the allowance for loan and lease losses account, accumulated unrealized gains and losses on available for sale securities, or other comprehensive income items.

Retained earnings ratio means the corporate credit union's retained earnings divided by its moving daily average net assets.

Section 107(8) institution means an institution described in Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)).

Securities lending means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

Senior management employee means a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller).

Settlement date means the date originally agreed to by a corporate credit union and a counterparty for settlement of the purchase or sale of a security.

Short sale means the sale of a security not owned by the seller.

Small business related security means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53)), i.e., a security, rated in one of the four highest rating categories by a nationally recognized statistical rating organization, that represents ownership of one or more promissory notes or leases of personal property which evidence the obligation of a small business concern. It does not mean a security issued or guaranteed by the Small Business Administration.

Stripped mortgage-backed security means a security that represents either the principal or interest only portion of the cash flows of an underlying pool of mortgages.

Trade date means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

Weighted average life means the weighted average time to principal repayment of a security based upon the proportional balances of the cash flows that make up the security.

When-issued trading means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

Wholesale corporate credit union means a corporate credit union which primarily serves other corporate credit unions.

§ 704.3 Corporate credit union capital.

(a) *Capital plan.* A corporate credit union must develop and ensure implementation of written short- and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.

(b) *Requirements for membership capital*—(1) *Form.* Membership capital funds may be in the form of a term certificate or an adjusted balance account.

(2) *Disclosure.* The terms and conditions of a membership capital account must be disclosed to the recorded owner of the account at the time the account is opened and at least annually thereafter.

(i) The initial disclosure must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board; and

(ii) The annual disclosure notice must be signed by the chair of the corporate credit union. The chair must sign a statement that certifies that the notice has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

(3) *Three-year remaining maturity.* When a membership capital account has been placed on notice or has a remaining maturity of less than

three years, the amount of the account that can be considered membership capital is reduced by a constant monthly amortization that ensures membership capital is fully amortized one year before the date of maturity or one year before the end of the notice period. The full balance of a membership capital account being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of the sum of retained earnings and paid-in capital until the funds are released by the corporate credit union at the time of maturity or the conclusion of the notice period.

(4) *Release.* Membership capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the membership capital transfers to the continuing credit union. In the event of a charter conversion, the membership capital transfers to the new institution. In the event of liquidation, the membership capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.

(5) *Sale.* A member may sell its membership capital to another member in the corporate credit union's field of membership, subject to the corporate credit union's approval.

(6) *Liquidation.* In the event of liquidation of a corporate credit union, membership capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders and the National Credit Union Share Insurance Fund (NCUSIF), but excluding paid-in capital.

(7) *Merger.* In the event of a merger of a corporate credit union, membership capital transfers to the continuing corporate credit union. The minimum three-year notice period for withdrawal of membership capital remains in effect.

(8) *Adjusted balance accounts:*

(i) May be adjusted no more frequently than once every six months; and

(ii) Must be adjusted in relation to a measure, *e.g.*, one percent of a member credit union's assets, established and disclosed at the time the account is opened without regard to any minimum withdrawal period. If the measure is other than assets, the corporate credit union must address the measure's permanency characteristics in its capital plan.

(iii) *Notice of withdrawal.* Upon written notice of intent to withdraw membership capital, the balance of the account will be frozen (no further adjustments) until the conclusion of the notice period.

(9) *Grandfathering.* Membership capital issued before the effective date of this regulation is exempt from the limitation of § 704.3(b)(8)(i).

(c) *Requirements for paid-in capital*—(1) *Disclosure.* The terms and conditions of any paid-in capital instrument must be disclosed to the recorded owner of the instrument at the time the instrument is created and must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board.

(2) *Release.* Paid-in capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the paid-in capital transfers to the continuing credit union. In the event of a charter conversion, the paid-in capital transfers to the new institution. In the event of liquidation, the paid-in capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.

(3) *Callability.* Paid-in capital accounts are callable on a pro-rata basis across an issuance class only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital and NEV ratios after the funds are called.

(4) *Liquidation.* In the event of liquidation of the corporate credit union, paid-in capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders, the NCUSIF, and membership capital holders.

(5) *Merger.* In the event of a merger of a corporate credit union, paid-in capital shall transfer to the continuing corporate credit union.

(6) *Paid-in capital.* Paid-in capital includes both member and nonmember paid-in capital.

(i) Member paid-in capital means paid-in capital that is held by the corporate credit union's members. A corporate credit union may not condition membership, services, or prices for services on a credit union's ownership of paid-in capital.

(ii) Nonmember paid-in capital means paid-in capital that is not held by the corporate credit union's members.

(7) *Grandfathering.* A corporate credit union's authority to include paid-in capital as a component of capital is governed by the regula-

tion in effect at the time the paid-in capital was issued. When a grandfathered paid-in capital instrument has a remaining maturity of less than 3 years, the amount that may be considered paid-in capital is reduced by a constant monthly amortization that ensures the paid-in capital is fully amortized 1 year before the date of maturity. The full balance of grandfathered paid-in capital being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of retained earnings until the funds are released by the corporate credit union at maturity.

(d) *Capital ratio.* A corporate credit union will maintain a minimum capital ratio of 4 percent, except as otherwise provided in this part. A corporate credit union must calculate its capital ratio at least monthly.

(e) *Individual capital ratio requirement*—(1) When significant circumstances or events warrant, the OCCU Director may require a different minimum capital ratio for an individual corporate credit union based on its circumstances. Factors that may warrant a different minimum capital ratio include, but are not limited to:

(i) An expectation that the corporate credit union has or anticipates losses resulting in capital inadequacy;

(ii) Significant exposure exists, unsupported by adequate capital or risk management processes, due to credit, liquidity, market, fiduciary, operational, and similar types of risks;

(iii) A merger has been approved; or

(iv) An emergency exists because of a natural disaster.

(2) When the OCCU Director determines that a different minimum capital ratio is necessary or appropriate for a particular corporate credit union, he or she will notify the corporate credit union in writing of the proposed capital ratio and the date by which the capital ratio must be reached. The OCCU Director also will provide an explanation of why the proposed capital ratio is considered necessary or appropriate.

(3)(i) The corporate credit union may respond to any or all of the items in the notice. The response must be in writing and delivered to the OCCU Director within 30 calendar days after the date on which the corporate credit union received the notice. The OCCU Director may shorten the time period when, in its opinion, the condition of the corporate credit union so requires, provided that the corporate credit union is informed promptly of the new time period, or with the consent of the corporate credit union. In its discretion, the OCCU Director may extend the time period for good cause.

(ii) Failure to respond within 30 calendar days or such other time period as may be specified by the OCCU Director shall constitute a waiver of any objections to any item in the notice. Failure to address any item in a response shall constitute a waiver of any objection to that item.

(iii) After the close of the corporate credit union's response period, the OCCU Director will decide, based on a review of the corporate credit union's response and other information concerning the corporate credit union, whether a different minimum capital ratio should be established for the corporate credit union and, if so, the capital ratio and the date the requirement must be reached. The corporate credit union will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish a different minimum capital ratio for the corporate credit union.

(f) *Failure to maintain minimum capital ratio requirement.* When a corporate credit union's capital ratio falls below the minimum required by paragraphs (d) or (e) of this section, or Appendix B to this part, as applicable, operating management of the corporate credit union must notify its board of directors, supervisory committee, and the OCCU Director within 10 calendar days.

(g) *Capital restoration plan.* (1) A corporate credit union must submit a plan to restore and maintain its capital ratio at the minimum requirement when either of the following conditions exist:

(i) The capital ratio falls below the minimum requirement and is not restored to the minimum requirement by the next month end; or

(ii) Regardless of whether the capital ratio is restored by the next month end, the capital ratio falls below the minimum requirement for three months in any 12-month period.

(2) The capital restoration plan must, at a minimum, include the following:

(i) Reasons why the capital ratio fell below the minimum requirement;

(ii) Descriptions of steps to be taken to restore the capital ratio to the minimum requirement within specific time frames;

(iii) Actions to be taken to maintain the capital ratio at the minimum required level and increase it thereafter;

(iv) Balance sheet and income projections, including assumptions, for the current calendar year and one additional calendar year; and

(v) Certification from the board of directors that it will follow the proposed plan if approved by the OCCU Director.

(3) The capital restoration plan must be submitted to the OCCU Director within 30 calendar days of the occurrence. The OCCU Director will respond to the corporate credit union regarding the adequacy of the plan within 45 calendar days of its receipt.

(h) *Capital directive.* (1) If a corporate credit union fails to submit a capital restoration plan; or the plan submitted is not deemed adequate to either restore capital or restore capital within a reasonable time; or the credit union fails to implement its approved capital restoration plan, NCUA may issue a capital directive.

(2) A capital directive may order a corporate credit union to:

(i) Achieve adequate capitalization within a specified time frame by taking any action deemed necessary, including but not limited to the following:

(A) Increase the amount of capital to specific levels;

(B) Reduce dividends;

(C) Limit receipt of deposits to those made to existing accounts;

(D) Cease or limit issuance of new accounts or any or all classes of accounts;

(E) Cease or limit lending or making a particular type or category of loans;

(F) Cease or limit the purchase of specified investments;

(G) Limit operational expenditures to specified levels;

(H) Increase and maintain liquid assets at specified levels; and

(I) Restrict or suspend expanded authorities issued under Appendix B of this part.

(ii) Adhere to a previously submitted plan to achieve adequate capitalization.

(iii) Submit and adhere to a capital plan acceptable to NCUA describing the means and a time schedule by which the corporate credit union shall achieve adequate capitalization.

(iv) Meet with NCUA.

(v) Take a combination of these actions.

(3) Prior to issuing a capital directive, NCUA will notify a corporate credit union in writing of its intention to issue a capital directive.

(i) The notice will state:

(A) The reasons for the issuance of the directive; and

(B) The proposed content of the directive.

(ii) A corporate credit union must respond in writing within 30 calendar days of receipt of the notice stating that it either concurs or disagrees with the notice. If it disagrees with the notice, it must state the reasons why the directive should not be issued and/or propose alternative contents for the directive. The response should include all matters that the corporate credit union wishes to be considered. For good cause, including the following conditions, the response time may be shortened or lengthened:

(A) When the condition of the corporate requires, and the corporate credit union is notified of the shortened response period in the notice;

(B) With the consent of the corporate credit union; or

(C) When the corporate credit union already has advised NCUA that it cannot or will not achieve adequate capitalization.

(iii) Failure to respond within 30 calendar days, or another time period specified in the notice, shall constitute a waiver of any objections to the proposed directive.

(4) After the closing date of the corporate credit union's response period, or the receipt of the response, if earlier, NCUA shall consider the response and may seek additional information or clarification. Based on the information provided during the response period, NCUA will determine whether or not to issue a capital directive and, if issued, the form it should take.

(5) Upon issuance, a capital directive and a statement of the reasons for its issuance will be delivered to the corporate credit union. A directive is effective immediately upon receipt by the corporate credit union, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by NCUA.

(6) A capital directive may be issued in addition to, or in lieu of, any other action authorized by law in response to a corporate credit union's failure to achieve or maintain the applicable minimum capital ratios.

(7) Upon a change in circumstances, a corporate credit union may request reconsideration of the terms of the directive. Requests that are not based on a significant change in circumstances or are repetitive or frivolous will not be considered. Pending a decision on reconsideration, the directive shall continue in full force and effect.

(i) *Earnings retention requirement.* A corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 2 percent.

(1) Its retained earnings must increase:

(i) During the current month, by an amount equal to or greater than the monthly earnings retention amount; or

(ii) During the current and prior two months, by an amount equal to or greater than the quarterly earnings retention amount.

(2) Earnings retention amounts are calculated as follows:

(i) The monthly earnings retention amount is determined by multiplying the earnings retention factor by the prior month-end moving daily average net assets; and

(ii) The quarterly earnings retention amount is determined by multiplying the earnings retention factor by moving daily average net assets for each of the prior three month-ends.

(3) The earnings retention factor is determined as follows:

(i) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is less than 3 percent, the earnings retention factor is .15 percent per annum; or

(ii) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .10 percent per annum.

(4) The OCCU Director may approve a decrease to the earnings retention amount if it is determined a lesser amount is necessary to avoid a significant adverse impact upon a corporate credit union.

(5) Operating management of the corporate credit union must notify its board of directors, supervisory committee, the OCCU Director and, if applicable, the state regulator within 10 calendar days of determining that the retained earnings ratio has declined below 2 percent. If the decline in the retained earnings ratio is due, in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 2 percent by the next month end, a retained earnings action plan is required to be submitted within 30 calendar days.

(6) The retained earnings action plan must be submitted to the OCCU Director and, if applicable, the state regulator and, at a minimum, include the following:

(i) Reasons why the dollar amount of retained earnings has decreased;

(ii) Description of actions to be taken to increase the dollar amount of retained earnings within specific time frames; and

(iii) Monthly balance sheet and income projections, including assumptions, for the next 12-month period.

§ 704.4 Board responsibilities.

(a) *General.* A corporate credit union's board of directors must approve comprehensive written strategic plans and policies, review them annually, and provide them upon request to the auditors, supervisory committee, and NCUA.

(b) *Policies.* A corporate credit union's policies must be commensurate with the scope and complexity of the corporate credit union.

(c) *Other requirements.* The board of directors of a corporate credit union must ensure:

(1) Senior managers have an in-depth, working knowledge of their direct areas of responsibility and are capable of identifying, hiring, and retaining qualified staff;

(2) Qualified personnel are employed or under contract for all line support and audit areas, and designated back-up personnel or resources with adequate cross-training are in place;

(3) GAAP is followed, except where law or regulation has provided for a departure from GAAP;

(4) Accurate balance sheets, income statements, and internal risk assessments (*e.g.*, risk management measures of liquidity, market, and credit risk associated with current activities) are produced timely in accordance with §§ 704.6, 704.8, and 704.9;

(5) Systems are audited periodically in accordance with industry-established standards;

(6) Financial performance is evaluated to ensure that the objectives of the corporate credit union and the responsibilities of management are met; and

(7) Planning addresses the retention of external consultants, as appropriate, to review the adequacy of technical, human, and financial resources dedicated to support major risk areas.

§ 704.5 Investments.

(a) *Policies.* A corporate credit union must operate according to an investment policy that is con-

sistent with its other risk management policies, including, but not limited to, those related to credit risk management, asset and liability management, and liquidity management. The policy must address, at a minimum:

(1) Appropriate tests and criteria for evaluating investments and investment transactions before purchase; and

(2) Reasonable and supportable concentration limits for limited liquidity investments in relation to capital.

(b) *General.* All investments must be U.S. dollar-denominated and subject to the credit policy restrictions set forth in § 704.6.

(c) *Authorized activities.* A corporate credit union may invest in:

(1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;

(2) Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(3) Corporate CUSOs, as defined in and subject to the limitations of § 704.11;

(4) Marketable debt obligations of corporations chartered in the United States. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and

(5) Domestically-issued asset-backed securities.

(d) *Repurchase agreements.* A corporate credit union may enter into a repurchase agreement provided that:

(1) The corporate credit union, directly or through its agent, receives written confirmation of the transaction, and either takes physical possession or control of the repurchase securities or is recorded as owner of the repurchase securities through the Federal Reserve Book-Entry Securities Transfer System;

(2) The repurchase securities are legal investments for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of the repurchase securities and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction; and

(4) The corporate credit union has entered into signed contracts with all approved counterparties and agents, and ensures compliance with the contracts. Such contracts must address any supplemental terms and conditions necessary to meet the specific requirements of this part. Third party arrangements must be supported by tri-party contracts in which the repurchase securities are priced and reported daily and the tri-party agent ensures compliance; and

(e) *Securities Lending.* A corporate credit union may enter into a securities lending transaction provided that:

(1) The corporate credit union, directly or through its agent, receives written confirmation of the loan, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System;

(2) The collateral is a legal investment for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral and maintains adequate margin that reflects a risk assessment of the collateral and terms of the loan; and

(4) The corporate credit union has entered into signed contracts with all agents and, directly or through its agent, has executed a written loan and security agreement with the borrower. The corporate or its agent ensures compliance with the agreements.

(f) *Investment companies.* A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), provided that the prospectus of the company restricts the investment portfolio to investments and investment transactions that are permissible for that corporate credit union.

(g) *Forward settlement of transactions later than regular way.* A corporate credit union may enter into an agreement to purchase or sell an instrument, with settlement later than regular way, provided that:

(1) Delivery and acceptance are mandatory;

(2) The transaction is clearly disclosed in the appropriate risk reporting required under § 704.8(b);

(3) If the corporate credit union is the purchaser, it has adequate cash flow projections

evidencing its ability to purchase the instrument;

(4) If the corporate credit union is the seller, it owns the instrument on the trade date; and

(5) The transaction is settled on a cash basis at the settlement date.

(h) *Prohibitions.* A corporate credit union is prohibited from:

(1) Purchasing or selling off balance sheet financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements;

(2) Engaging in trading securities unless accounted for on a trade date basis;

(3) Engaging in adjusted trading or short sales; and

(4) Purchasing stripped mortgage-backed securities, mortgage servicing rights, small business related securities, or residual interests in CMOs or asset-backed securities.

(i) *Conflicts of interest.* A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.

(j) *Grandfathering.* A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

§ 704.6 Credit risk management.

(a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment risks and activities it undertakes. The policy must address at a minimum:

(1) The approval process associated with credit limits;

(2) Due diligence analysis requirements;

(3) Maximum credit limits with each obligor and transaction counterparty, set as a percentage of capital. In addition to addressing deposits and securities, limits with transaction counterparties must address aggregate exposures of all transactions including, but not limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, originator of receivables, insurer, industry type, sector type, and geographic).

(b) *Exemption.* The requirements of this section do not apply to investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or enterprises (excluding subordinated debt) or are fully insured (including accumulated interest) by the NCUSIF or Federal Deposit Insurance Corporation.

(c) *Concentration limits*—(1) *General rule.* The aggregate of all investments in any single obligor is limited to 50 percent of capital or $5 million, whichever is greater.

(2) *Exceptions.* Exceptions to the general rule are:

(i) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of capital;

(ii) Investments in corporate CUSOs are subject to the limitations of § 704.11; and

(iii) Aggregate investments in corporate credit unions are not subject to the limitations of paragraph (c)(1) of this section.

(3) For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's capital at the time of the transaction. An investment that fails a requirement of this section because of a subsequent reduction in capital will be deemed nonconforming. A corporate credit union is required to exercise reasonable efforts to bring nonconforming investments into conformity within 90 calendar days. Investments that remain nonconforming for 90 calendar days will be deemed to fail a requirement of this section and the corporate credit union will have to comply with § 704.10.

(d) *Credit ratings.*—(1) All investments, other than in a corporate credit union or CUSO, must have an applicable credit rating from at least one nationally recognized statistical rating organization (NRSRO).

(2) At the time of purchase, investments with long-term ratings must be rated no lower than AA– (or equivalent) and investments with short-term ratings must be rated no lower than A–1 (or equivalent).

(3) Any rating(s) relied upon to meet the requirements of this part must be identified at the time of purchase and must be monitored for as long as the corporate owns the investment.

(4) When two or more ratings are relied upon to meet the requirements of this part at

the time of purchase, the board or an appropriate committee must place on the § 704.6(e)(1) investment watch list any investment for which a rating is downgraded below the minimum rating requirements of this part.

(5) Investments are subject to the requirements of § 704.10 if:

(i) One rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or

(ii) Two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.

(e) *Reporting and documentation.* (1) At least annually, a written evaluation of each credit limit with each obligor or transaction counterparty must be prepared and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive an investment watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit limit;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit limit.

§ 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to members*—(1) *Credit unions.* (i) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of capital.

(ii) The maximum aggregate amount in secured loans and lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, must not exceed 100 percent of capital.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(3) *Other members.* The maximum aggregate amount of loans and lines of credit to any other one member must not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(d) *Loans to nonmembers*—(1) *Credit unions.* A loan to a nonmember credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to § 704.12. Generally, such a loan will have a maturity of one business day.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(e) *Member business loan rule.* Loans, lines of credit and letters of credit to:

(1) Member credit unions are exempt from part 723 of this chapter;

(2) Corporate CUSOs are not subject to part 723 of this chapter.

(3) Other members not excluded under § 723.1(b) of this chapter must comply with part 723 of this chapter unless the loan or line of credit is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. Those guaranteed and secured loans must comply with the aggregate limits of § 723.16 but are exempt from the other requirements of part 723.

(f) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(g) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

§ 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the interest rate risk simulation tests set forth in paragraph (d) of this section; and

(5) The modeling of indexes that serve as references in financial instrument coupon formulas; and

(6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV, compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 basis points on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;

(iii) Adjustments to the market spread assumptions for non Treasury instruments to consider the impact of widening spreads; and

(iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Regulatory violations.* If a corporate credit union's decline in NEV, base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by this rule and is not brought into compliance within 10 calendar days, operating management of the corporate credit union must immediately report the information to the board of directors, supervisory committee, and the OCCU Director. If any violation persists for 30 calendar days, the corporate credit union must submit a detailed, written action plan to the OCCU Director that sets forth the time needed and means by which it intends to correct the violation. If the OCCU Director determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the OCCU Director.

(f) *Policy violations.* If a corporate credit union's decline in NEV, base case NEV ratio, or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by its board, it must determine how

it will bring the exposure within policy limits. The disclosure to the board of the violation must occur no later than its next regularly scheduled board meeting.

§ 704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor sources of internal and external liquidity;

(3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) *Borrowing.* A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

§ 704.10 Investment action plan.

(a) Any corporate credit union in possession of an investment, including a derivative, that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee and the OCCU Director. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to the OCCU Director a written action plan that addresses:

(1) The investment's characteristics and risks;

(2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;

(3) How the investment fits into the credit union's asset and liability management strategy;

(4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and

(5) The likelihood that the investment may again pass the requirements of this part.

(b) The OCCU Director may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.

(c) If the plan described in paragraph (a) of this section is not approved by the OCCU Director, the credit union must adhere to the OCCU Director's directed course of action.

§ 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

(a) A corporate CUSO is an entity that:

(1) Is at least partly owned by a corporate credit union;

(2) Primarily serves credit unions;

(3) Restricts its services to those related to the normal course of business of credit unions; and

(4) Is structured as a corporation, limited liability company, or limited partnership under state law.

(b) *Investment and loan limitations.* (1) The aggregate of all investments in member and nonmember corporate CUSOs must not exceed 15 percent of a corporate credit union's capital.

(2) The aggregate of all investments in and loans to member and nonmember corporate CUSOs must not exceed 30 percent of a corporate credit union's capital. A corporate credit union may lend to member and nonmember corporate CUSOs an additional 15 percent of capital if the loan is collateralized by assets in which the corporate has a perfected security interest under state law.

(3) If the limitations in paragraphs (b)(1) and (b)(2) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method without an additional cash outlay by the corporate, divestiture is not required. A corporate credit union may continue to invest up to the regulatory limit without regard to the increase in the GAAP valuation resulting from the corporate CUSO's profitability.

(c) *Due diligence.* A corporate credit union must comply with the due diligence requirements of §§ 723.5 and 723.6(f) through (j) of this chapter for all loans to corporate CUSOs. This requirement does not apply to loans excluded under § 723.1(b).

(d) *Separate entity.* (1) A corporate CUSO must be operated as an entity separate from a corporate credit union.

(2) A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that concludes the corporate CUSO is organized and operated in a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to "pierce the corporate veil," such as inadequate capitalization, lack of corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.

(e) *Prohibited activities.* A corporate credit union may not use this authority to acquire control, directly or indirectly, of another depository financial institution or to invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility, or similar organization.

(f) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.

(g) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the corporate CUSO will:

(1) Follow GAAP;

(2) Provide financial statements to the corporate credit union at least quarterly;

(3) Obtain an annual CPA opinion audit and provide a copy to the corporate credit union. A wholly owned or majority owned CUSO is not required to obtain a separate annual audit if it is included in the corporate credit union's annual consolidated audit; and

(4) Allow the auditor, board of directors, and NCUA complete access to its books, records, and any other pertinent documentation.

(h) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not authorized to invest in or loan to a CUSO under part 712 of this chapter.

§ 704.12 Permissible services.

(a) *Preapproved services.* A corporate credit union may provide to members the preapproved services set out in this section. NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit or prohibit any preapproved service. The specific activities listed within each preapproved category are provided as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

(1) *Correspondent services agreement.* A corporate credit union may only provide financial services to nonmembers through a correspondent services agreement. A correspondent services agreement is an agreement between two corporate credit unions, whereby one of the corporate credit unions agrees to provide services to the other corporate credit union or its members.

(2) *Credit and investment services.* Credit and investment services are advisory and consulting activities that assist the member in lending or investment management. These services may include loan reviews, investment portfolio reviews and investment advisory services.

(3) *Electronic financial services.* Electronic financial services are any services, products, functions, or activities that a corporate credit union is otherwise authorized to perform, provide or deliver to its members but performed through electronic means. Electronic services may include automated teller machines, online transaction processing through a website, website hosting services, account aggregation services, and internet access services to perform or deliver products or services to members.

(4) *Excess capacity.* Excess capacity is the excess use or capacity remaining in facilities, equipment or services that: a corporate credit union properly invested in or established, in good faith, with the intent of serving its members; and it reasonably anticipates will be taken up by the future expansion of services to its members. A corporate credit union may sell or lease the excess capacity in facilities, equipment or services, such as office space, employees and data processing.

(5) *Liquidity and asset and liability management.* Liquidity and asset and liability management services are any services, functions or activities that assist the member in liquidity and balance sheet management. These services may include liquidity planning and balance sheet modeling and analysis.

(6) *Operational services.* Operational services are services established to deliver financial products and services that enhance member service and promote safe and sound operations. Operational services may include tax payment, electronic fund transfers and providing coin and currency service.

(7) *Payment systems.* Payment systems are any methods used to facilitate the movement of funds for transactional purposes. Payment systems may include Automated Clearing House, wire transfer, item processing and settlement services.

(8) *Trustee or custodial services.* Trustee services are services in which the corporate credit union is authorized to act under a written trust agreement to the extent permitted under part 724 of this chapter. Custodial and safekeeping services are services a corporate credit union performs on behalf of its member to act as custodian or safekeeper of investments.

(b) *Procedure for adding services that are not preapproved.* To provide a service to its members that is not preapproved by NCUA:

(1) A federal corporate credit union must request approval from NCUA. The request must include a full explanation and complete documentation of the service and how the service relates to a corporate credit union's authority to provide services to its members. The request must be submitted jointly to the OCCU Director and the Secretary of the Board. The request will be treated as a petition to amend § 704.12 and NCUA will request public comment or otherwise act on the petition within a reasonable period of time. Before engaging in the formal approval process, a corporate credit union should seek an advisory opinion from NCUA's Office of General Counsel as to whether a proposed service is already covered by one of the authorized categories without filing a petition to amend the regulation; and

(2) A state-chartered corporate credit union must submit a request for a waiver that complies with § 704.1(b) to the OCCU Director.

(c) *Prohibition.* A corporate credit union is prohibited from purchasing loan servicing rights.

§ 704.13 [Removed and Reserved].

§ 704.14 Representation.

(a) *Board representation.* The board will be determined as stipulated in its bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association; and

(5) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.

(b) *Credit union trade association.* As used in this section, a credit union trade association includes but is not limited to, state credit union leagues and league service corporations and national credit union trade associations.

(c) *Representatives of organizational members.* (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its

members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.

(d) *Recusal provision.* (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.

(2) An individual is "interested" in an entity if he or she:

(i) Serves as a director, officer, or employee of the entity;

(ii) Has a business, ownership, or deposit relationship with the entity; or

(iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.

(3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) In the event of the disqualification of any committee member by operation of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(e) *Administration.* (1) A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.

(2) The provisions of § 701.14 of this chapter apply to corporate credit unions, except that where "Regional Director" is used, read "NCUA Board."

§ 704.15 Audit requirements.

(a) *External audit.* The corporate credit union supervisory committee shall cause an annual opinion audit of the financial statements to be made. The audit must be performed in accordance with generally accepted auditing standards and the audited financial statements must be prepared consistent with GAAP, except where law or regulation has provided for a departure from GAAP. The supervisory committee shall submit the audit report to the board of directors. A copy of the audit report, and copies of all communications that are provided to the corporate credit union by the external auditor, shall be submitted to the OCCU Director within 30 calendar days after receipt by the board of directors. If requested by the OCCU Director, the external auditor's workpapers shall be made available, at the auditor's office or elsewhere, for the OCCU Director's review. The corporate credit union shall submit a summary of the audit report to the membership at the next annual meeting.

(b) *Internal audit.* A corporate credit union with average daily assets in excess of $400 million for the preceding calendar year, or as ordered by the OCCU Director, must employ or contract, on a full- or part-time basis, the services of an internal auditor. The internal auditor's responsibilities will, at a minimum, comply with the Standards and Professional Practices of Internal Auditing, as established by the Institute of Internal Auditors. The internal auditor will report directly to the chair of the corporate credit union's supervisory committee, who may delegate supervision of the internal auditor's daily activities to the chief executive officer of the corporate credit union. The internal auditor's reports, findings, and recommendations will be in writing and presented to the supervisory committee no less than quar-

terly, and will be provided upon request to the external auditor and the OCCU Director.

§ 704.16 Contracts/written agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§ 704.17 State-chartered corporate credit unions.

(a) This part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

(b) A state-chartered corporate credit union that is not insured by the NCUSIF, but that receives funds from federally insured credit unions, is considered an "institution-affiliated party" within the meaning of Section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(c) NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union.

§ 704.18 Fidelity bond coverage.

(a) *Scope.* This section provides the fidelity bond requirements for employees and officials in corporate credit unions.

(b) *Review of coverage.* The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

(c) *Minimum coverage; approved forms.* Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of NCUA. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by NCUA, requiring written notification by surety to NCUA:

(1) When the bond of a credit union is terminated in its entirety;

(2) When bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or

(3) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.

(d) *Minimum coverage amounts.* (1) The minimum amount of bond coverage will be computed based on the corporate credit union's daily average net assets for the preceding calendar year. The following table lists the minimum requirements:

Daily average net assets	Minimum bond (million)
Less than $50 million	$1.0
$50–$99 million	2.0
$100–$499 million	4.0
$500–$999 million	6.0
$1.0–$1.999 billion	8.0
$2.0–$4.999 billion	10.0
$5.0–$9.999 billion	15.0
$10.0–$24.999 billion	20.0
$25.0 billion plus	25.0

(2) It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the minimums in the table in paragraph (d)(1) of this section.

(e) *Deductibles.* (1) The maximum amount of deductibles allowed are based on the corporate credit union's core capital ratio. The following table sets out the maximum deductibles, except that in each category the maximum deductible shall be $5 million:

Core Capital ratio	Maximum deductible
Less than 1.0 percent	7.5 percent of the sum of retained earnings and paid-in capital.
1.0–1.74 percent	10.0 percent of the sum of retained earnings and paid-in capital.
1.75–2.24 percent	12.0 percent of the sum of retained earnings and paid-in capital.
Greater than 2.25 percent	15.0 percent of the sum of retained earnings and paid-in capital.

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of NCUA at least 30 calendar days prior to the effective date of the deductibles.

(f) *Additional coverage.* NCUA may require additional coverage for any corporate credit union when, in the opinion of NCUA, current coverage is insufficient. The board of directors of the corporate credit union must obtain additional coverage within 30 calendar days after the date of written notice from NCUA.

§ 704.19 Wholesale corporate credit unions.

(a) *General.* Wholesale corporate credit unions are subject to the preceding requirements of this part, except as set forth in this section.

(b) *Earnings retention requirement.* A wholesale corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 1 percent.

(1) Its retained earnings must increase:

(i) During the current month, by an amount equal to or greater than the monthly earnings retention amount; or

(ii) During the current and prior two months, by an amount equal to or greater than the quarterly earnings retention amount.

(2) Earnings retention amounts are calculated as follows:

(i) The monthly earnings retention amount is determined by multiplying the earnings retention factor by the prior month-end moving daily average net assets; and

(ii) The quarterly earnings retention amount is determined by multiplying the earnings retention factor by moving daily average net assets for each of the prior three month-ends.

(3) The earnings retention factor is determined as follows:

(i) If the prior month-end retained earnings ratio is less than 1 percent and the core capital ratio is less than 3 percent, the earnings retention factor is .15 percent per annum; or

(ii) If the prior month-end retained earnings ratio is less than 1 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .075 percent per annum.

(4) The OCCU Director may approve a decrease to the earnings retention amount set forth in this section if it is determined a lesser amount is necessary to avoid a significant adverse impact upon a wholesale corporate credit union.

(5) Operating management of the wholesale corporate credit union must notify its board of directors, supervisory committee, OCCU Director and, if applicable, the state regulator within 10 calendar days of determining the retained earnings ratio has declined below 1 percent. If the decline in the retained earnings ratio is due in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 1 percent by the next month end, a retained earnings action plan is required to be submitted within 30 calendar days.

(6) The retained earnings action plan must be submitted to the OCCU Director and, if applicable, the state regulator and, at a minimum, include the following:

(i) Reasons why the dollar amount of retained earnings has decreased;

(ii) Description of actions to be taken to increase the dollar amount of retained earnings within specific time frames; and

(iii) Monthly balance sheet and income projections, including assumptions for the ensuing 12-month period.

Appendix A to Part 704—Model Forms

This appendix contains sample forms intended for use by corporate credit unions to aid in compliance with the membership capital account and paid-in capital disclosure requirements of § 704.3.

SAMPLE FORM 1

Terms and Conditions of Membership Capital Account

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A membership capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the membership capital account transfers to the continuing credit union. In the event of a charter conversion, the membership capital account transfers to the new institution.

In the event of liquidation, the membership capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) A member credit union may withdraw membership capital with three years' notice.

(4) Membership capital cannot be used to pledge borrowings.

(5) Membership capital is available to cover losses that exceed retained earnings and paid-in capital.

(6) Where the corporate credit union is liquidated, membership capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.

(7) Where the corporate credit union is merged into another corporate credit union, the membership capital account will transfer to the continuing corporate credit union. The three-year notice period for withdrawal of the membership capital account will remain in effect.

(8) {If an adjusted balance account}: The membership capital balance will be adjusted ____(1 or 2)_____ time(s) annually in relation to the member credit union's _____(assets or other measure) _____ as of _____(date(s))_____. {If a term certificate}: The membership capital account is a term certificate that will mature on _____(date)_____.

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The notice form must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

The annual disclosure notice form must be signed by the chair of the corporate credit union. The chair must then sign a statement that certifies that the notice has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

SAMPLE FORM 2

Terms and Conditions of Paid-In Capital

(1) A paid-in capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A paid-in capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the paid-in capital account transfers to the continuing credit union. In the event of a charter conversion, the paid-in capital account transfers to the new institution. In the event of liquidation, the paid-in capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called.

(4) Paid-in capital cannot be used to pledge borrowings.

(5) Paid-in capital is available to cover losses that exceed retained earnings.

(6) Where the corporate credit union is liquidated, paid-in capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, and membership capital holders.

(7) Where the corporate credit union is merged into another corporate credit union, the paid-in capital account will transfer to the continuing corporate credit union.

(8) Paid-in capital is perpetual maturity and noncumulative dividend.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

Appendix B to Part 704—Expanded Authorities and Requirements

A corporate credit union may obtain all or part of the expanded authorities contained in this Appendix if it meets the applicable requirements of Part 704 and Appendix B, fulfills additional management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. Additional guidance is set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority.

A corporate credit union seeking expanded authorities must submit to NCUA a self-assessment plan supporting its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate credit union of the reason(s) for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan detailing how it has corrected the deficiency.

Minimum Requirement

In order to participate in any of the authorities set forth in Base-Plus, Part I, Part II, Part III, Part IV, and Part V of this Appendix, a corporate credit union must evaluate monthly the changes in NEV and the NEV ratio for the tests set forth in § 704.8(d)(1)(i).

Base-Plus

A corporate that has met the requirements for this Base-plus authority may, in performing the rate stress tests set forth in § 704.8(d)(1)(i), allow its NEV to decline as much as 20 percent.

Part I

(a) A corporate credit union that has met the requirements for this Part I may:

(1) Purchase investments with long-term ratings no lower than A– (or equivalent);

(2) Purchase investments with short-term ratings no lower than A–2 (or equivalent), provided that the issuer has a long-term rating no lower than A– (or equivalent) or the investment is a domestically-issued asset-backed security;

(3) Engage in short sales of permissible investments to reduce interest rate risk;

(4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and

(5) Enter into a dollar roll transaction.

(b) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 300 percent of capital.

(c) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union that has met the requirements of this Part I may decline as much as:

(1) 20 percent;

(2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or

(3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.

(d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

Part II

(a) A corporate credit union that has met the requirements for this Part II may:

(1) Purchase investments with long-term ratings no lower than BBB (flat) (or equivalent). The aggregate of all investments rated BBB+ (or equivalent) or lower in any single obligor is not to exceed 25 percent of capital;

(2) Purchase investments with short-term ratings no lower than A–2 (or equivalent), provided that the issuer has a long-term rating no lower than BBB (flat) (or equivalent) or the investment is a domestically issued asset-backed security;

(3) Engage in short sales of permissible investments to reduce interest rate risk;

(4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and

(5) Enter into a dollar roll transaction.

(b) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 400 percent of capital.

(c) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of this Part II may decline as much as:

(1) 20 percent;

(2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or

(3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.

(d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

Part III

(a) A corporate credit union that has met the requirements of either Part I or Part II of this Appendix and the additional requirements for Part III may invest in:

(1) Debt obligations of a foreign country;

(2) Deposits and debt obligations of foreign banks or obligations guaranteed by these banks;

(3) Marketable debt obligations of foreign corporations. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and

(4) Foreign issued asset-backed securities.

(b) All foreign investments are subject to the following requirements:

(1) Investments must be rated no lower than the minimum permissible domestic rating under the corporate credit union's Part I or Part II authority;

(2) A sovereign issuer, and/or the country in which an obligor is organized, must have a long-term foreign currency (non-local currency) debt rating no lower than AA– (or equivalent);

(3) For each approved foreign bank line, the corporate credit union must identify the specific banking centers and branches to which it will lend funds;

(4) Obligations of any single foreign obligor may not exceed 50 percent of capital; and

(5) Obligations in any single foreign country may not exceed 250 percent of capital.

Part IV

(a) A corporate credit union that has met the requirements for this Part IV may enter into derivative transactions specifically approved by NCUA to:

(1) Create structured products;

(2) Manage its own balance sheet; and

(3) Hedge the balance sheets of its members.

(b) Credit Ratings:

(1) All derivative transactions are subject to the following requirements:

(i) If the counterparty is domestic, the counterparty rating must be no lower than the minimum permissible rating for comparable term permissible investments; and

(ii) If the counterparty is foreign, the corporate must have Part III expanded authority and the counterparty rating must be no lower that the minimum permissible rating for a comparable term investment under Part III Authority.

(iii) Any rating(s) relied upon to meet the requirements of this part must be identified at the time the transaction is entered into and must be monitored for as long as the contract remains open.

(iv) Section 704.10 of this part if:

(A) one rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or

(B) two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.

(2) Exceptions. Credit ratings are not required for derivative transactions with:

(i) Domestically chartered credit unions;

(ii) U.S. government sponsored enterprises; or

(iii) Counterparties if the transaction is fully guaranteed by an entity with a minimum permissible rating for comparable term investments.

Part V

A corporate credit union that has met the requirements for this Part V may participate in loans with member natural person credit unions as approved by the OCCU Director and subject to the following:

(a) The maximum aggregate amount of participation loans with any one member credit union must not exceed 25 percent of capital; and

(b) The maximum aggregate amount of participation loans with all member credit unions will be determined on a case-by-case basis by the OCCU Director.

Part 705

Community Development Revolving Loan Program For Credit Unions

§ 705.0 Applicability.

Monies from the Community Development Revolving Loan Fund for Credit Unions are governed by this Part.

§ 705.1 Scope.

(a) This Part implements the Community Development Revolving Loan Program for Credit Unions (Program) under the sole administration of the National Credit Union Administration.

(b) This Part establishes the following:

(1) Definitions;

(2) The application process and requirements for qualifying for a loan under the program;

(3) How loan funds are to be made available and their repayment; and

(4) Technical assistance to be provided to participating credit unions.

§ 705.2 Purpose of the Program.

(a) The Community Development Revolving Loan Program for Credit Unions is intended to support the efforts of participating credit unions through loans to those credit unions in:

(1) Providing basic financial and related services to residents in their communities; and

(2) Stimulating economic activities in the communities they service which will result in increased income, ownership and employment opportunities for low-income residents, and other community growth efforts.

(b) The policy of NCUA is to revolve loan funds to qualifying credit unions as often as practical in order to gain maximum economic impact on as many participating credit unions as possible.

§ 705.3 Definitions.

(a)(1) The term "low-income members" shall mean those members who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those members whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau or those members otherwise defined as low-income members as determined by order of the NCUA Board.

(2) In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the standards, Regional Directors shall make allowances for geographical areas with higher costs of living. The following is the exclusive list of geographic areas and the differentials to be used:

	Percent
Hawaii	40
Alaska	36
Washington, DC	19
Boston	17
San Diego	15
Los Angeles	14
New York	13
San Francisco	13
Seattle	10
Chicago	7
Philadelphia	7

(b) For purposes of this part, a *participating credit union* means a state- or federally-chartered credit union (excluding student credit unions) that is specifically involved in the stimulation of economic development activities and community revitalization efforts aimed at benefiting the community it serves; whose membership consists of predominantly low-income members as defined in paragraph (a) of this section or applicable state standards as reflected by a current low-income designation pursuant to § 701.34(a)(1) or § 741.204 of this chapter or, in the case of a state-chartered nonfederally insured credit union, under applicable state standards; and has submitted an application for a loan and/or technical assistance and has been selected for participation in the Program in accordance with this part.

§ 705.4 Program Activities.

In order to meet the objectives of the Program, a credit union applicant should provide a variety of financial and related services designed to meet the particular needs of the low-income community served. These activities shall include basic member share accounts and member loan services.

§ 705.5 Application for Participation.

(a) Applications to participate and qualify for a loan or technical assistance under the Program may be obtained from the National Credit Union Administration, Community Development Revolving Loan Program for Credit Unions.

(b) The application for a loan shall contain the following information:

(1) Information demonstrating a sound financial position and the credit union's ability to manage its day-to-day business affairs, including the credit union's latest financial statement. Nonfederally insured credit unions must include the following:

(i) A copy of its most recent outside audit report;

(ii) Proof of deposit and surety bond insurance which states the maximum insurance levels permitted by the policies;

(iii) A balance sheet, an income and expense statement, and a schedule of delinquent loans, for the most recent month-end and each of the twelve months preceding that month-end.

(2) Evidence that the credit union has a need for increased funds in order to improve financial services to its members.

(3) The following information concerning a state-chartered credit union's field of membership:

(i) Current field of membership as set forth in the credit union's charter;

(ii) Changes, if any, to be made to the field of membership for participation in the Program, including:

(A) Evidence of approval of change by credit union board of directors;

(B) Evidence of submission and approval of change by the state supervisor;

(iii) Current designation as a low-income credit union if the credit union is not federally insured.

(4) Along with a community needs plan, specifics of how the credit union proposes to serve the needs of its members and the community with Program funds. The applicant credit union will also construct and submit a plan for its growth and development. The plan will set forth objectives for financial growth, credit union development and capitalization, and the means for achieving these objectives.

(5) Indication of any other involvement in existing community development programs of state and federal agencies.

(c) NCUA will notify applicant credit unions as to whether or not they have qualified for a loan or technical assistance under this Part. Reasons for nonqualification will be stated. Any applicant whose qualification is denied may appeal that decision to the NCUA Board.

§ 705.6 Community Needs Plan.

(a) The credit union's board of directors will prepare a Community Needs Plan and submit it with its loan application. The Plan will contain a list of needed community services that the credit union will provide.

(b) The credit union's board of directors will report on the progress of providing needed community services to the credit union members once a year, either at the annual meeting or in a written report sent to all members. The credit union will also submit the written report or a summary of the report given at the annual meeting to NCUA.

§ 705.7 Loans to Participating Credit Unions.

(a) *Amount and Recording of Loans.* A participating credit union will be eligible to receive up to $300,000, in the aggregate as determined by the NCUA Board, in the form of a loan from the Community Development Revolving Loan Fund for Credit Unions. The amount of the loan will be based on funds availability, the creditworthiness of the participating credit union, financial need, and a demonstrated capability of a participating credit union to provide financial and related services to its members. At the discretion of NCUA, a loan will be recorded by a participating credit union as either a note payable or a nonmember deposit.

(b) *Matching Requirements.* Participating credit unions will be encouraged to develop, as rapidly as possible, a permanent source of member shares.

(1) Generally loan monies made available must be matched by the participating credit

union by increasing its share deposits in an amount equal to the loan amount. However, any loan monies matched by member share deposits will be credited as two-for-one match. Nonmember share deposits accepted to meet the matching requirement are not subject to the 20 percent limitation on nonmember deposits under § 701.32. Participating credit unions must meet this matching requirement within one year of the approval of the loan application and must maintain the increase in the total amount of share deposits for the duration of the loan. Once the loan is repaid, nonmember share deposits accepted to meet the matching requirement are subject to § 701.32.

(2) Upon approval of its loan application, and before it meets its matching requirement, a participating credit union may receive the entire loan commitment in a single payment. If any funds are withheld, the remainder of the funds committed will be available to the participating credit union only after it has documented that it has met the match requirement for the total amount of the loan committed.

(3) Failure of a participating credit union to generate the required match within one year of the approval of the loan will result in the reduction of the loan proportionate to the amount of match actually generated. Payment of any additional funds initially approved will be limited as appropriate to reflect the revised amount of the loan approved. Any funds already advanced to the participating credit union in excess of the revised amount of loan approval must be repaid immediately to NCUA. Failure to repay such funds to NCUA upon demand shall result in the default of the entire loan.

(c) *Terms and Repayment.* (1) Assistance made available through Program loans, whether recorded by the credit union as a note payable or nonmember deposit at NCUA's direction, is in the form of a loan and must be repaid to NCUA. All loans will be scheduled for repayment within the shortest time compatible with sound business practices and with objectives of the Program, but in no case will the term exceed five years.

(2) Semiannual interest payments (beginning six months after the initial distribution of a loan) and semiannual principal payments (beginning one year after the initial distribution of a loan) will be required.

(d) *Interest Rates.* Loans made under this Part shall bear interest at a fixed annual percentage rate of not more than 3 percent and not less than 1 percent as determined by the NCUA Board.

(e) *Default, Collections and Adjustments.* The terms of each loan agreement shall provide for the immediate acceleration of the unpaid balance for breach or default in the performance by the participating credit union of the terms or conditions of the loan. This will include misrepresentations, default in making interest/principal payments, failure to report, insolvency, failure to maintain adequate match for the duration of the loan period, etc. The unpaid balance will also be accelerated and immediately due if any part of the loan funds are improperly used, or if uninvested loan proceeds remain unused for an unreasonable or unjustified period of time.

§ 705.8 State-Chartered Credit Unions.

State-chartered credit union loan applicants approved for participation by NCUA must obtain written concurrence from their respective state regulatory authority. Such applicants shall make copies of their state examination reports available to NCUA and shall agree to examination by NCUA for the limited purpose of compliance with this Part.

§ 705.9 Application Period.

NCUA will announce annually and publish in the Federal Register when applications for participation in the Program may be submitted. Such notice will be dependent upon the availability of funds.

§ 705.10 Technical Assistance.

NCUA may provide technical assistance to participating credit unions directly or through outside providers selected by the credit unions or NCUA. NCUA will base technical assistance on funds availability, the needs of the participating credit union, and a demonstrated capability of the participating credit union to provide financial and related services to its members. NCUA will consider applications for technical assistance and determine whether to grant them in accordance with established procedures and standards that are publicly available. Participating credit unions can be provided with technical assistance without obtaining a Program loan. NCUA technical assistance will aid participating credit unions in providing services to their members and in the efficient operation of such credit unions.

Part 706

Credit Practices

§ 706.1 Definitions.

(a) *Person.* An individual, corporation, or other business organization.

(b) *Consumer.* A natural person member who seeks or acquires goods, services, or money for personal, family, or household use.

(c) *Obligation.* An agreement between a consumer and a Federal credit union.

(d) *Debt.* Money that is due or alleged to be due from one to another.

(e) *Earnings.* Compensation paid or payable to an individual or for his or her account for personal services rendered or to be rendered by him or her, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

(f) *Household goods.* Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings) of the consumer and his or her dependents, provided that the following are not included within the scope of the term "household goods":

(1) Works of art;

(2) Electronic entertainment equipment (except one television and one radio);

(3) Items acquired as antiques; and

(4) Jewelry (except wedding rings).

(g) *Antique.* Any item over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character.

(h) *Cosigner.* A natural person who renders himself or herself liable for the obligation of another person without receiving goods, services, or money in return for the credit obligation, or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the obligation. The term includes any person whose signature is requested as a condition to granting credit to a consumer, or as a condition for forbearance on collection of a consumer's obligation that is in default. The term does not include a spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law. A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation.

§ 706.2 Unfair Credit Practices.

(a) In connection with the extension of credit to consumers, it is an unfair act or practice for a Federal credit union, directly or indirectly, to take or receive from a consumer an obligation that:

(1) Constitutes or contains a cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

(2) Constitutes or contains an executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(3) Constitutes or contains an assignment of wages or other earnings unless:

(i) The assignment by its terms is revocable at the will of the debtor, or

(ii) The assignment is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment, or

(iii) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(4) Constitutes or contains a nonpossessory security interest in household goods other than a purchase money security interest.

§ 706.3 Unfair or Deceptive Cosigner Practices.

(a) *Prohibited practices.* In connection with the extension of credit to consumers, it is:

(1) A deceptive act or practice for a Federal credit union, directly or indirectly, to misrepresent the nature or extent of cosigner liability to any person.

(2) An unfair act or practice for a Federal credit union, directly or indirectly, to obligate a cosigner unless the cosigner is informed prior to becoming obligated, which in the case of open-end credit means prior to the time that the agreement creating the cosigner's liability for future charges is executed, of the nature of his or her liability as cosigner.

(b) Disclosure requirement.

(1) To comply with the cosigner information requirement of paragraph (a)(2), a clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to becoming obligated. The disclosure statement will contain only the following statement, or one which is substantially equivalent, and shall either be a separate document or included in the documents evidencing the consumer credit obligation.

NOTICE TO COSIGNER

> You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.
>
> You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.
>
> The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.
>
> This notice is not the contract that makes you liable for the debt.

(2) If the notice to cosigner is a separate document, nothing other than the following items may appear with the notice. Items (i) through (v) may not be part of the narrative portion of the notice to cosigner.

(i) The name and address of the Federal credit union;

(ii) An identification of the debt to be cosigned (e.g., a loan identification number);

(iii) The amount of the loan;

(iv) The date of the loan;

(v) A signature line for a cosigner to acknowledge receipt of the notice; and

(vi) To the extent permitted by state law, a cosigner notice required by state law may be included in the paragraph (b)(1) notice.

(3) To the extent the notice to cosigner specified in paragraph (b)(1) refers to an action against a cosigner that is not permitted by state law, the notice to cosigner may be modified.

§ 706.4 Late Charges.

(a) In connection with collecting a debt arising out of an extension of credit to a consumer, it is an unfair act or practice for a Federal credit union, directly or indirectly, to levy or collect any delinquency charge on a payment, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s).

(b) For purposes of this section, "collecting a debt" means any activity other than the use of judicial process that is intended to bring about or does bring about repayment of all or part of a consumer debt.

§ 706.5 State Exemptions.

(a) If, upon application to the NCUA by an appropriate state agency, the NCUA determines that:

(1) there is a state requirement or prohibition in effect that applies to any transaction to which a provision of this rule applies; and

(2) the state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this rule; then that provision of this rule will not be in effect in the state to the extent specified by the NCUA in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

(b) States that received an exemption from the Federal Trade Commission's Credit Practices Rule prior to September 17, 1987, are not required to reapply to NCUA for an exemption under subparagraph (a) of this section provided that the state forwards a copy of its exemption determination to the appropriate Regional Office. NCUA will honor the exemption for as long as the state administers and enforces the state requirement or

prohibition effectively. Any state seeking a greater exemption than that granted to it by the Federal Trade Commission must apply to NCUA for the exemption.

Part 707

Truth in Savings

§ 707.1 Authority, purpose, coverage and effect on state laws.

(a) *Authority.* This part is issued by the National Credit Union Administration Board to implement the Truth in Savings Act of 1991 (TISA), contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. § 4301 *et seq.,* Pub. L. No. 102–242, 105 Stat. 2236).

(b) *Purpose.* The purpose of this part is to enable credit union members and potential members to make informed decisions about accounts at credit unions. This part requires credit unions to provide disclosures so that members and potential members can make meaningful comparisons among credit unions and depository institutions.

(c) *Coverage.* This part applies to all credit unions whose accounts are either insured by, or eligible to be insured by, the National Credit Union Share Insurance Fund, except for any credit union that has been designated as a corporate credit union by the National Credit Union Administration and any credit union that has $2 million or less in assets, after subtracting any nonmember deposits, and is determined to be nonautomated by the National Credit Union Administration. In addition, the advertising rules in § 707.8 apply to any person who advertises an account offered by a credit union, including any person who solicits any amount from any other person for placement in a credit union.

(d) *Effect on state laws.* State law requirements that are inconsistent with the requirements of the TISA and this part are preempted to the extent of the inconsistency.

§ 707.2 Definitions.

For purposes of this part, the following definitions apply:

(a) *Account* means a share or deposit account at a credit union held by or offered to a member or potential member. It includes, but is not limited to, accounts such as share, share draft, checking and term share accounts. For purposes of the advertising regulations in § 707.8, the term also includes an account at a credit union that is held by or offered by a share or deposit broker.

(b) *Advertisement* means a commercial message, appearing in any medium, that promotes directly or indirectly the availability of, or a deposit in, an account.

(c) *Annual percentage yield* means a percentage rate reflecting the total amount of dividends paid on an account, based on the dividend rate and the frequency of compounding for a 365-day period and calculated according to the rules in Appendix A of this part.

(d) *Average daily balance method* means the application of a periodic rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) *Board* means the National Credit Union Administration Board.

(f) *Bonus* means a premium, gift, award, or other consideration worth more than $10 (whether in the form of cash, credit, merchandise, or any equivalent) given or offered to a member during a year in exchange for opening, maintaining, or renewing an account, or increasing an account balance. The term does not include dividends, other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends.

(g) *Credit union* means a federal or state-chartered credit union that is either insured by, or is eligible to apply for insurance from, the National Credit Union Share Insurance Fund.

(h) *Daily balance method* means the application of a daily periodic rate to the full amount of principal in the account each day.

(i) *Dividend and dividends* mean any declared or prospective earnings on a member's shares in a credit union to be paid to a member or to the member's account. For purposes of this part, the term does not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends.

(j) *Dividend declaration date* means the date that the board of directors of a credit union de-

clares a dividend for the preceding dividend period.

(k) *Dividend period* means the span of time established by the board of directors of a credit union by the end of which shares in a member account earn dividend credit. The dividend period may be different for each type of account.

(l) *Dividend rate* means the declared or prospective annual dividend rate paid on an account, which does not reflect compounding. For purposes of the account disclosures in § 707.4(b)(1)(i), the rate may, but need not, be referred to as the "annual percentage rate" in addition to being referred to as the "dividend rate."

(m) *Extraordinary dividends* means a nonrepetitive dividend paid at an irregular time from funds legally available for such distribution.

(n) *Fixed-rate account* means an account that is not a variable rate account as defined in paragraph (z) of this section.

(o) *Grace period* means a period following the maturity of an automatically renewing term share account during which the member may withdraw funds without being assessed a penalty.

(p) *Interest* means any payment to a member or to a member's account for the use of funds in a nondividend-bearing account at a state-chartered credit union offered pursuant to state law, calculated by application of a periodic rate to the balance. For purposes of this regulation, the term does not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends. Except as is specifically otherwise provided in this part, in the case of an interest-bearing account held in or offered by a state-chartered credit union pursuant to state law, the word "interest" shall be substituted for all references to "dividend" or "dividends" in this part.

(q) *Member* means:

(1) A natural person member of the credit union who holds an account primarily for personal, family, or household purposes;

(2) A natural person nonmember who holds an account primarily for personal, family, or household purposes, either jointly with a natural person member or in a credit union designated as a low-income credit union, or to whom such an account is offered; and

(3) A natural person nonmember who holds a deposit account in a state-chartered credit union pursuant to state law, or to whom such deposit account is offered.

The term does not include a natural person who holds an account for another in a professional capacity or an unincorporated nonbusiness association of natural person members.

(r) *Non-dividend membership benefits* means any property or service provided by a credit union to its members, the nature of which makes its valuation unreasonable and administratively impracticable.

(s) *Passbook account* means an account in which the member retains a book or other document in which the credit union records transactions on the account.

(t) *Periodic statement* means a statement setting forth information about an account (other than a term share account or passbook account) that is provided to a member on a regular basis four or more times a year.

(u) *Potential member* means a natural person within the credit union's field of membership (or an unincorporated nonbusiness association of such persons) or otherwise eligible to become a member as defined in paragraph (q) of this section.

(v) *State* means a state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

(w) *Stepped-rate account* means an account that has two or more dividend rates that take effect in succeeding periods and are known when the account is opened.

(x) *Term share account* means any share certificate, interest-bearing certificate of deposit account, or other account with a maturity of at least seven days in which the member generally does not have a right to make withdrawals for six days after the account is opened, unless the account is subject to an early withdrawal penalty of at least seven days' dividends on amounts withdrawn, offered by a credit union to a member or potential member.

(y) *Tiered-rate account* means an account that has two or more dividend rates that are applicable to specified balance levels.

(z) *Variable-rate account* means a share, share draft, checking, or term share account in which the simple dividend rate may change after the account is opened, unless the credit union contracts to give at least thirty days advance written notice of rate decreases.

§ 707.3 General disclosure requirements.

(a) *Form.* Credit unions must make the disclosures required by §§ 707.4 through 707.6 and § 707.10 of this part, as applicable, clearly and

conspicuously in writing and in a form the member or potential member may keep. Disclosures for each account offered by a credit union may be presented separately or combined with disclosures for the credit union's other accounts, as long as it is clear which disclosures are applicable to the member's account.

(b) *General.* The disclosures shall reflect the terms of the legal obligation between the member and the credit union. Disclosures may be made in languages other than English, provided the disclosures are available in English upon request.

(c) *Relation to Regulation E (12 CFR part 205).* Disclosures required by and provided in accordance with the Electronic Fund Transfer Act (15 U.S.C. 1601) and its implementing Regulation E (12 CFR part 205) that are also required by this part may be substituted for the disclosures required by this part.

(d) *Multiple members.* If an account is held by more than one member, disclosures may be made to any one of the members.

(e) *Oral responses to inquiries.* In an oral response to a member or potential member's inquiry about dividend rates payable on its accounts, the credit union shall state the annual percentage yield. The dividend rate may be stated in addition to the annual percentage yield. No other rate may be stated. In stating a dividend rate and annual percentage yield, a credit union shall:

(1) For dividend-bearing accounts other than term share accounts, specify a dividend rate and annual percentage yield as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective dividend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(2) For interest-bearing accounts and for dividend-bearing term share accounts, specify an interest (dividend) rate and annual percentage yield that were offered within the most recent seven calendar days; state that the rate and yield are accurate as of an identified date; and provide a telephone number members may call to obtain current rate information.

(f) *Rounding and accuracy rules for rates and yields.*

(1) *Rounding.* The annual percentage yield, the annual percentage yield earned, and the dividend rate shall be rounded to the nearest one-hundredth of one percentage point (.01%) and expressed to two decimal places. For account disclosures, the dividend rate may be expressed to more than two decimal places.

(2) *Accuracy.* The annual percentage yield (and the annual percentage yield earned) will be considered accurate if not more than one-twentieth of one percentage point (.05%) above or below the annual percentage yield (and the annual percentage yield earned) determined in accordance with the rules in Appendix A of this part.

(g) Electronic communication. For rules governing the electronic delivery of disclosures, including the definition of electronic communication, see § 707.10.

§ 707.4 Account disclosures.

(a) Delivery of account disclosures.—(1) *Account opening.*—(i) *General.* A credit union must provide account disclosures to a member or potential member before an account is opened or a service is provided, whichever is earlier. A credit union is deemed to have provided a service when a fee required to be disclosed is assessed. Except as provided in paragraph (a)(1)(ii) of this section, if the member is not present at the credit union when the account is opened or the service is provided and has not already received the disclosures, the credit union must mail or deliver the disclosures no later than 10 business days after the account is opened or the service is provided, whichever is earlier.

(ii) *Electronic communication.* If a member or potential member who is not present at the credit union uses electronic communication (as defined in § 707.10) to open an account or request a service, the disclosures required under paragraph (a)(1) of this section must be provided before an account is opened or a service is provided.

(2) *Requests.* (i) A credit union must provide account disclosures to a member or potential member upon request. If a member who is not present at the credit union makes a request, the credit union must mail or deliver the disclosures within a reasonable time after it receives the request and may provide the disclosures in paper form, or electronically if the member provides an electronic mail address.

(ii) In providing disclosures upon request, the credit union may:

(A) Specify rates as follows:

(*1*) For dividend-bearing accounts other than term share accounts, specify a dividend rate and annual percentage yield as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective dividend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(*2*) For interest-bearing accounts and for dividend-bearing term share accounts, specify an interest rate and annual percentage yield that were offered within the most recent seven calendar days; state that the rate and yield are accurate as of an identified date; and provide a telephone number members may call to obtain current rate information; and

(B) State the maturity of a term share account as either a term or a date.

(b) Content of account disclosures. Account disclosures shall include the following, as applicable:

(1) *Rate information.*

(i) *Annual percentage yield and dividend rate.*

(A) For interest-bearing accounts and for dividend-bearing term share accounts, the "annual percentage yield" and the "interest rate" ("dividend rate"), using those terms, and for fixed-rate accounts the period of time the interest (dividend) rate will be in effect.

(B) For dividend-bearing accounts other than term share accounts, a credit union shall specify a dividend rate and annual percentage yield (using those terms) as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective dividend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(ii) *Variable rates.* For variable-rate accounts:

(A) The fact that the dividend rate and annual percentage yield may change;

(B) How the dividend rate is determined;

(C) The frequency with which the dividend rate may change; and

(D) Any limitation on the amount the dividend rate may change.

(2) *Compounding and crediting.*

(i) *Frequency.* The frequency with which dividends are compounded and credited, and the dividend period for dividend-bearing accounts.

(ii) *Effect of closing an account.* If members will forfeit dividends if they close an account before accrued dividends are credited, a statement that the dividends will not be paid in such cases.

(3) *Balance information.*

(i) *Minimum balance requirements.* Any minimum balance required to:

(A) Open the account;

(B) Avoid the imposition of a fee; or

(C) Obtain the annual percentage yield disclosed.

Except for the balance to open the account, the disclosure shall state how the balance is determined for these purposes.

(ii) *Balance computation method.* An explanation of the balance computation method specified in § 707.7, used to calculate dividends on the account.

(iii) *When dividends begin to accrue.* A statement of when dividends begin to accrue on noncash deposits.

(4) *Fees.* The amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed.

(5) *Transaction limitations.* Any limitations on the number or dollar amount of withdrawals or deposits.

(6) *Features of Term Share Accounts.* For term share accounts:

(i) *Time requirements.* The maturity date.

(ii) *Early withdrawal penalties.* A statement that a penalty will be imposed for early withdrawal, how it is calculated, and the conditions for its assessment.

(iii) *Withdrawal of dividends prior to maturity.* If compounding occurs and dividends may be withdrawn prior to maturity, a statement that the annual percentage yield assumes

dividends remain in the account until maturity and that a withdrawal will reduce earnings. For accounts with a stated maturity greater than one year that do not compound dividends on an annual or more frequent basis, that require dividend payouts at least annually, and that disclose an APY determined in accordance with section E of appendix A of this part, a statement that dividends cannot remain on account and that payout of dividends is mandatory.

(iv) *Renewal policies.* A statement of whether or not the account will renew automatically at maturity. If it will, a statement of whether or not a grace period will be provided and, if so, the length of that period must be stated. If the account will not renew automatically, a statement of whether dividends will be paid after maturity if the member does not renew the account must be stated.

(7) *Bonuses.* The amount or type of any bonus, when the bonus will be provided, and any minimum balance and time requirements to obtain the bonus.

(8) *Nature of dividends.* For accounts earning dividends, other than term share accounts, a statement that dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

(c) *Notice to existing account holders.*

(1) *Notice of availability of disclosures.* Credit unions shall provide a notice to members who receive periodic statements and who hold existing accounts of the type offered by the credit union on January 1, 1995. The notice shall be included on or with the first periodic statement sent after January 1, 1995 (or on or with the first periodic statement for a statement cycle beginning on or after that date). The notice shall state that the members may request account disclosures containing terms, fees, and rate information for the account. In responding to such a request, credit unions shall provide disclosures in accordance with paragraph (a)(2) of this section.

(2) *Alternative to notice.* As an alternative to the notice described in paragraph (c)(1) of this section, credit unions may provide account disclosures to members. The disclosures may be provided either with a periodic statement or separately, but must be sent no later than when the periodic statement described in paragraph (c)(1) of this section is sent.

§ 707.5 Subsequent disclosures.

(a) *Change in terms.*

(1) *Advance notice required.* A credit union shall give advance notice to affected members of any change in a term required to be disclosed under § 707.4(b), if the change may reduce the annual percentage yield or adversely affect the member. The notice shall include the effective date of the change. The notice shall be mailed or delivered at least 30 calendar days before the effective date of the change.

(2) *No notice required.* No notice under this section is required for:

(i) *Variable-rate changes.* Changes in the dividend rate and corresponding changes in the annual percentage yield in variable-rate accounts.

(ii) *Share draft and check printing fees.* Changes in fees for check printing.

(iii) *Short-term term share accounts.* Changes in any term for term share accounts with maturities of one month or less.

(b) *Notice before maturity for term share accounts longer than one month that renew automatically.* For term share accounts with a maturity longer than one month that renew automatically at maturity, credit unions shall provide the disclosures described below before maturity. The disclosures shall be mailed or delivered at least 30 calendar days before maturity of the existing account. Alternatively, the disclosures may be mailed or delivered at least 20 calendar days before the end of the grace period on the existing account, provided a grace period of at least five calendar days is allowed.

(1) *Maturities of longer than one year.* If the maturity is longer than one year, the credit union shall provide account disclosures set forth in § 707.4(b) for the new account, along with the date the existing account matures. If the dividend rate and annual percentage yield that will be paid for the new account are unknown when disclosures are provided, the credit union shall state that those rates have not yet been determined, the date when they will be determined, and a telephone number members may call to obtain the dividend rate and the annual percentage yield that will be paid for the new account.

(2) *Maturities of one year or less but longer than one month.* If the maturity is one year or less but longer than one month, the credit union shall either:

(i) Provide disclosures as set forth in paragraph (b)(1) of this section; or

(ii) Disclose to the member:

(A) The date the existing account matures and the new maturity date if the account is renewed;

(B) The dividend rate and the annual percentage yield for the new account if they are known (or that those rates have not yet been determined, the date when they will be determined, and a telephone number the member may call to obtain the dividend rate and the annual percentage yield that will be paid for the new account); and

(C) Any difference in the terms of the new account as compared to the terms required to be disclosed under § 707.4(b) for the existing account.

(c) *Notice before maturity for term share accounts longer than one year that do not renew automatically.* For term share accounts with a maturity longer than one year that do not renew automatically at maturity, credit unions shall disclose to members the maturity date and whether dividends will be paid after maturity. The disclosures shall be mailed or delivered at least 10 calendar days before maturity of the existing account.

§ 707.6 Periodic statement disclosures.

(a) *Rule when statement and crediting periods vary.* In making the disclosures described in paragraph (b) of this section, credit unions that calculate and credit dividends for a period other than the statement period, such as the dividend period, may calculate and disclose the annual percentage yield earned and amount of dividends earned based on that period rather than the statement period. The information in paragraph (b)(4) shall be stated for that period as well as for the statement period.

(b) *Statement disclosures.* If a credit union mails or delivers a periodic statement, the statement shall include the following disclosures:

(1) *Annual percentage yield earned.* The "annual percentage yield earned," using that term as calculated according to the rules in Appendix A of this part.

(2) *Amount of dividends.* The dollar amount of dividends earned (accrued or paid and credited) on the account. The dollar amount of any extraordinary dividends earned during the statement period shall be shown as a separate figure.

(3) *Fees imposed.* Fees required to be disclosed under § 707.4(b)(4) of this part and imposed on the account during the statement period. The fees shall be itemized by type and dollar amounts.

(4) *Length of period.* The total number of days in the statement period, or the beginning and ending dates of the period.

§ 707.7 Payment of dividends.

(a) *Permissible methods.*

(1) *Balance on which dividends are calculated.* Credit unions shall calculate dividends on the full amount of principal in an account for each day by use of either the daily balance method or the average daily balance method. Credit unions shall calculate dividends by use of a daily rate of at least 1/365 of the dividend rate. In a leap year a daily rate of 1/366 of the dividend rate may be used.

(2) *Determination of minimum balance to earn dividends.* A credit union shall use the same method to determine any minimum balance required to earn dividends as it uses to determine the balance on which dividends are calculated. A credit union may use an additional method that is unequivocally beneficial to the member.

(b) *Compounding and crediting policies.* This section does not require credit unions to compound or credit dividends at any particular frequency.

(c) *Date dividends begin to accrue.* Dividends shall begin to accrue not later than the day specified in § 606 of the Expedited Funds Availability Act (12 U.S.C. 4005) and implementing Regulation CC (12 CFR part 229). Dividends shall accrue on funds until the day funds are withdrawn.

§ 707.8 Advertising.

(a) *Misleading or inaccurate advertisements.* An advertisement shall not be misleading or inaccurate and shall not misrepresent a credit union's account contract. An advertisement shall not refer to or describe an account as "free" or "no cost" (or contain a similar term) if any maintenance or activity fee may be imposed on the account. The word "profit" shall not be used in referring to interest paid on an account.

(b) *Permissible rates.* If an advertisement states a rate of return, it shall state the rate as an "an-

nual percentage yield," using that term. (The abbreviation "APY" may be used provided the term "annual percentage yield" is stated at least once in the advertisement.) The advertisement shall not state any other rate, except that the "dividend rate," using that term, may be stated in conjunction with, but not more conspicuously than, the annual percentage yield to which it relates.

(c) *When additional disclosures are required.* Except as provided in paragraph (e) of this section, if the annual percentage yield is stated in an advertisement, the advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) *Variable rates.* For variable-rate accounts, a statement that the rate may change after the account is opened.

(2) *Time annual percentage yield is offered.* For interest-bearing accounts and dividend-bearing term share accounts, the period of time the annual percentage yield will be offered, or a statement that the annual percentage yield is accurate as of a specified date. For dividend-bearing accounts other than term share accounts, a statement that the annual percentage yield is accurate as of the last dividend declaration date. In the event that disclosure of an annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective annual percentage yield. Such prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(3) *Minimum balance.* The minimum balance required to earn the advertised annual percentage yield. For tiered-rate accounts, the minimum balance required for each tier shall be stated in close proximity and with equal prominence to the applicable annual percentage yield.

(4) *Minimum opening deposit.* The minimum deposit required to open the account, if it is greater than the minimum balance necessary to earn the advertised annual percentage yield.

(5) *Effect of fees.* A statement that fees could reduce the earnings on the account.

(6) *Features of term share accounts.* For term share accounts:

(i) *Time requirements.* The term of the account.

(ii) *Early withdrawal penalties.* A statement that a penalty will or may be imposed for early withdrawal.

(iii) *Required dividend payouts.* For noncompounding term share accounts with a stated maturity greater than one year that do not compound dividends on an annual or more frequent basis, that require dividend payouts at least annually, and that disclose an APY determined in accordance with section E of appendix A of this part, a statement that dividends cannot remain on account and that payout of dividends is mandatory.

(d) *Bonuses.* Except as provided in paragraph (e) of this section, if a bonus is stated in an advertisement, the advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) The "annual percentage yield," using that term;

(2) The time requirements to obtain the bonus;

(3) The minimum balance required to obtain the bonus;

(4) The minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and

(5) When the bonus will be provided.

(e) *Exemption for certain advertisements.*

(1) *Certain media.* If an advertisement is made through one of the following media, it need not contain the information in paragraphs (c)(1), (c)(2), (c)(4), (c)(5), (c)(6)(ii), (d)(4) and (d)(5) of this section:

(i) Broadcast or electronic media, such as television or radio;

(ii) Outdoor media, such as billboards; or

(iii) Telephone response machines.

(2) *Indoor signs.*

(i) Signs inside the premises of a credit union (or the premises of a share or deposit broker) are not subject to paragraphs (b), (c), (d) or (e)(1) of this section.

(ii) If a sign exempted by paragraph (e)(2) of this section states a rate of return, it shall:

(A) State the rate as an "annual percentage yield," using that term or the term "APY." The sign shall not state any other rate, except that the dividend rate may be stated in conjunction with the annual percentage yield to which it relates.

(B) Contain a statement advising members to contact an employee for further information about applicable fees and terms.

(3) *Newsletters.*

(i) Newsletters sent by a credit union to existing members only are not subject to paragraphs (b), (c), (d) or (e)(1) of this section.

(ii) If a newsletter exempted by paragraph (e)(3) of this section states a rate of return, it shall:

(A) State the rate as an "annual percentage yield," using that term or the term "APY." The newsletter shall not state any other rate, except that the dividend rate may be stated in conjunction with the annual percentage yield to which it relates.

(B) Contain a statement advising members to contact an employee for further information about applicable fees and terms.

§ 707.9 Enforcement and record retention.

(a) *Administrative enforcement.* Section 270 of TISA (12 U.S.C. 4309) contains the provisions relating to administrative sanctions for failure to comply with the requirements of TISA and this part.

(b) *Civil liability.* Section 271 of TISA (12 U.S.C. 4310) contains the provisions relating to civil liability for failure to comply with the requirements of TISA and this part; Section 271 is repealed effective September 30, 2001.

(c) *Record retention.* A credit union shall retain evidence of compliance with this regulation for a minimum of two years after the date disclosures are required to be made or action is required to be taken.

§ 707.10 Electronic communication.

(a) Definition. Electronic communication means a message transmitted electronically between a credit union and a member in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor.

(b) General rule. In accordance with the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) (15 U.S.C. 7001 *et seq.*) and the rules of this part, a credit union may provide by electronic communication any disclosure required by this part to be in writing.

(c) When consent is required. Under the E-Sign Act, a credit union must obtain a member's affirmative consent when providing disclosures related to a transaction. For purposes of this requirement, the disclosures required under §§ 707.4(a)(2) and 707.8 are deemed not to be related to a transaction.

(d) Address or location to receive electronic communication. A credit union that uses electronic communication to provide disclosures required by this part must:

(1) Send the disclosure to the member's electronic address; or

(2) Make the disclosure available at another location such as an Internet web site; and

(i) Alert the member of the disclosure's availability by sending a notice to the member's electronic address (or to a postal address, at the credit union's option). The notice must identify the account involved (if applicable) and the address of the Internet web site or other location where the disclosure is available; and

(ii) Make the disclosure available for at least 90 days from the date the disclosure first becomes available or from the date of the notice alerting the member of the disclosure, whichever comes later.

(3) Exceptions. A credit union need not comply with paragraph (d)(2)(ii) of this section for disclosures required under § 707.4(a)(2), and need not comply with paragraphs (d)(2)(i) and (ii) of this section for disclosures required under § 707.8.

(e) Redelivery. When a disclosure provided by electronic communication is returned to a credit union undelivered, the credit union must take reasonable steps to attempt redelivery using information in its files.

(f) Entities other than a credit union. A person other than a credit union that is required to comply with this part may use electronic communication in accordance with the requirements of this section, as applicable.*

*Credit unions choosing to make disclosures and advertisements electronically may either follow the requirements as outlined in 707.4, 707.10 and Appendix C of this part or the requirements of the Electronics Signatures in Global and National Commerce Act, (15 U. S. C. 7001 et seq., E-Sign Act). *See* Supplementary Information published in 66 Fed. Reg. 33159 (6/21/01) and 66 Fed. Reg. 48206 (9/19/01) for a discussion of electronic disclosure requirements. This supplementary information was distributed with the November 2001 publication of the NCUA Rules and Regulations.

Appendix A to Part 707—Annual Percentage Yield Calculation

The annual percentage yield (APY) measures the total amount of dividends a credit union pays on an account based on the dividend rate and the frequency of compounding. The annual percentage yield is expressed as an annualized rate, based on a 365-day year. (Credit unions may calculate the annual percentage yield based on a 365-day or a 366-day year in a leap year.) Part I of this appendix discusses the annual percentage yield calculations for account disclosures and advertisements, while Part II discusses annual percentage yield earned calculations for statements. The annual percentage yield reflects only dividends and does not include the value of any bonus, as that term is defined in part 707, that may be provided to the member to open, maintain, increase or renew an account. Dividends, interest or other earnings are not to be included in the annual percentage yield if such amounts are determined by circumstances that may or may not occur in the future. These formulas apply to both dividend-bearing and interest-bearing accounts held by credit unions.

Part I. Annual Percentage Yield for Account Disclosures and Advertising Purposes

In general, the annual percentage yield for account disclosures under §§ 707.4 and 707.5 and for advertising under § 707.8 is an annualized rate that reflects the relationship between the amount of dividends that would be earned by the member for the term of the account and the amount of principal used to calculate those dividends. The amount of dividends that would be earned may be projected based on the most recent past declared rate or an anticipated future rate, whichever the credit union judges to most reasonably approximate the dividends to be earned. Special rules apply to accounts with tiered and stepped dividend rates, and to certain term share accounts with a stated maturity greater than one year.

A. General rules

Except as provided in Part I. E. of this appendix, the annual percentage yield shall be calculated by the formula shown below. Credit unions may calculate the annual percentage yield using projected dividends based on either the rate at the last dividend declaration date or the rate anticipated at a future date. The credit union must disclose whichever option it uses to members. Credit unions shall calculate the annual percentage yield based on the actual number of days for the term of the account. For accounts without a stated maturity date (such as a typical share or share draft account), the calculation shall be based on an assumed term of 365 days. In determining the total dividends figure to be used in the formula, credit unions shall assume that all principal and dividends remain on deposit for the entire term, and that no other transactions (deposits or withdrawals) occur during the term. (This assumption shall not be used if a credit union requires, as a condition of the account, that members withdraw dividends during the term. In such a case, the dividends (and annual percentage yield calculation) shall reflect that requirement.) For term share accounts that are offered in multiples of months, credit unions may base the number of days on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. If credit unions choose to use this permissive rule, they must use the same number of days to calculate the dollar amount of dividends that will be earned on the account in the annual percentage yield formula (where "Dividends" are divided by "Principal".)

The annual percentage yield is to be calculated by use of the following general formula (("APY") is used for convenience in the formulas):

$$APY = 100[(1 + \text{Dividends/Principal})^{(365\ /\text{Days in term})} - 1]$$

"Principal" is the amount of funds assumed to have been deposited at the beginning of the account.

"Dividends" is the total dollar amount of dividends earned on the Principal for the term of the account.

"Days in term" is the actual number of days in the term of the account.

When the "days in term" is 365 (that is, where the stated maturity is 365 days or where the account does not have a stated maturity), the APY can be calculated by use of the following simple formula:

$$APY = 100\ (\text{Dividends/Principal}).$$

EXAMPLES:

(1) If a credit union would pay $61.68 in dividends for a 365-day year on $1,000 deposited into a share draft account, the APY is 6.17%:

$$APY = 100\ [(1 + 61.68/1{,}000)^{(365/365)} - 1]$$

APY = 6.17%

Or, using the simple formula above (since the term is deemed to be 365 days):

APY = 100 (61.68/1,000)

APY = 6.17%

(2) If a credit union pays $30.37 in dividends on a $1,000 six-month term share certificate account (where the six-month period used by the credit union contains 182 days), using the general formula above, the APY is 6.18%:

$$APY = 100\ [(1 + 30.37/1{,}000)^{(365/182)} - 1]$$

APY = 6.18%

The APY is affected by the frequency of compounding, i.e., the amount of dividends will be greater the more frequently dividends are compounded for a given nominal rate. When two credit unions are offering the same dividend rate on, for example, a share account, the APY disclosed may be different if the credit unions use a different frequency of compounding.

EXAMPLES:

(1) If a credit union pays $1,268.25 in dividends for a 365-day year on $10,000 deposited into a regular share account earning 12%, and the dividends are compounded monthly, the APY will be 12.68%:

APY = 100 ($1,268.25/10,000)

APY = 12.68%

(2) However, if a credit union is compounding dividends on a quarterly basis on an account which otherwise has the same terms, the dividends will be $1,255.09 and the APY will be 12.55%:

APY = 100 ($1,255.09/10,000)

APY = 12.55%

B. Stepped-Rate Accounts (Different Rates Apply in Succeeding Periods)

For accounts with two or more dividend rates applied in succeeding periods (where the rates are known at the time the account is opened), a credit union shall assume each dividend rate is in effect for the length of time provided for in any share agreement.

EXAMPLES:

(1) If a credit union offers a $1,000 6-month term share (certificate) account on which it pays a 5% dividend rate, compounded daily, for the first three months (which contain 91 days), and a 5.5% dividend rate, compounded daily, for the next three months (which contain 92 days), the total dividends for six months is $26.68, and, using the general formula above, the APY is 5.39%:

$$APY = 100\ [(1 + 26.68/1{,}000)^{(365/183)} - 1]$$

APY = 5.39%

(2) If a credit union offers a $1,000 2-year share certificate on which it pays a 6% dividend rate, compounded daily, for the first year, and a 6.5% dividend rate, compounded daily, for the next year, the total dividends for two years is $133.13, and, using the general formula above, the APY is 6.45%:

$$APY = 100[(1 + 133.13/1{,}000)^{(365/730)} - 1]$$

APY = 6.45%

C. Variable-Rate Accounts

For variable-rate accounts without an introductory premium or discounted rate, a credit union must base the calculation only on the initial dividend rate in effect when the account is opened (or advertised), and assume that this rate will not change during the year.

Variable-rate accounts with an introductory premium or discount rate must be treated like stepped-rate accounts. Thus, a credit union shall assume that: (1) the introductory simple dividend rate is in effect for the length of time provided for in the account contract; and (2) the variable dividend rate that would have been in effect when the account is opened or advertised (but for the introductory rate) is in effect for the remainder of the year. If the variable rate is tied to an index, the index-based rate in effect at the time of disclosure must be used for the remainder of the year. If the rate is not tied to an index, the rate in effect for existing members holding the same account (who are not receiving the introductory dividend rate) must be used for the remainder of the year.

For example, if a credit union offers an account on which it pays a 7% dividend rate, com-

pounded daily, for the first three months (which, for example, contains 91 days), while the variable dividend rate that would have been in effect when the account was opened was 5%, the total dividends for a 365-day year for a $1,000 account balance is $56.52, (based on 91 days at 7% followed by 274 days at 5%). Using the simple formula, the APY is 5.65%:

APY = 100 (56.52/1,000)

APY = 5.65%

D. Accounts With Tiered Rates (Different Rates Apply To Specified Balance Level)

For accounts in which two or more dividend rates paid on the account are applicable to specified balance levels, the credit union must calculate the annual percentage yield in accordance with the method described below that it uses to calculate dividends. In all cases, an annual percentage yield (or a range of annual percentage yields, if appropriate) must be disclosed for each balance tier.

For purposes of the examples discussed below, assume the following:

Simple dividend rate	*Share balance required to earn rate*
5.25%	up to but not exceeding $2,500
5.50%	above $2,500, but not exceeding $15,000
5.75%	above $15,000.

Tiering Method A

Under this method, a credit union pays on the full balance in the account the stated dividend rate that corresponds to the applicable share balance tier. For example, if a member deposits $8,000, the credit union pays the 5.50% dividend rate on the entire $8,000. This is also known as a "hybrid" or "plateau" tiered rate account.

When this method is used to determine dividends, only one annual percentage yield will apply to each tier. Within each tier, the annual percentage yield will not vary with the amount of principal assumed to have been deposited. For the dividend rates and account balances assumed above, the credit union will state three annual percentage yields—one corresponding to each balance tier. Calculation of each annual percentage yield is similar for this type of account as for accounts with a single fixed dividend rate. Thus, the calculation is based on the total amount of dividends that would be received by the member for each tier of the account for a year and the principal assumed to have been deposited to earn that amount of dividends.

First tier. Assuming daily compounding, the credit union will pay $53.90 in dividends on a $1,000 account balance. Using the general formula for the first tier, the APY is 5.39%:

$$APY = 100\ [(1 + 53.90/1{,}000)^{(365/365)} - 1]$$

APY = 5.39%

Using the simple formula:

APY = 100 (53.90/1,000)

APY = 5.39%

Second tier. The credit union will pay $452.29 in dividends on a $8,000 deposit. Thus, using the simple formula, the annual percentage yield for the second tier is 5.65%:

APY = 100 (452.29/8,000)

APY = 5.65%

Third tier. The credit union will pay $1,183.61 in dividends on a $20,000 account balance. Thus, using the simple formula, the annual percentage yield for the third tier is 5.92%:

APY = 100 (1,183.61/20,000)

APY = 5.92%

Tiering Method B

Under this method, a credit union pays the stated dividend rate only on that portion of the balance within the specified tier. For example, if a member deposits $8,000, the credit union pays 5.25% on only $2,500 and 5.50% on $5,500 (the difference between $8,000 and the first tier cutoff of $2,500). This is also known as a "pure" tiered rate account.

The credit union that computes dividends in this manner must provide a range that shows the lowest and the highest annual percentage yields for each tier (other than for the first tier, which, like the tiers in Method A, has the same annual percentage yield throughout). The low figure for an annual percentage yield is calculated based on the total amount of dividends earned for a year assuming the minimum principal required to earn the dividend rate for that tier. The high figure for an annual percentage yield is based on the amount of dividends the credit union would pay on the highest principal

that could be deposited to earn that same dividend rate. If the account does not have a limit on the amount that can be deposited, the credit union may assume any amount.

For the tiering structure assumed above, the credit union would state a total of five annual percentage yields—one figure for the first tier and two figures stated as a range for the other two tiers.

First tier. Assuming daily compounding, the credit union could pay $53.90 in dividends on a $1,000 account balance. For this first tier, using the simple formula, the annual percentage yield is 5.39%:

APY = 100 (53.90/1,000)

APY = 5.39%

Second tier. For the second tier the credit union would pay between $134.75 and $841.45 in dividends, based on assumed balances of $2,500.01 and $15,000, respectively. For $2,500.01, dividends would be figured on $2,500 at 5.25% dividend rate plus dividends on $.01 at 5.50%. For the low end of the second tier, therefore, the annual percentage yield is 5.39%. Using the simple formula:

APY = 100 (134.75/2,500)

APY = 5.39%

For $15,000, dividends are figured on $2,500 at 5.25% dividend rate plus dividends on $12,500 at 5.50% dividend rate. For the high end of the second tier, the annual percentage yield, using the simple formula, is 5.61%:

APY = 100 (841.45/15,000)

APY = 5.61%

Thus, the annual percentage yield range that would be stated for the second tier is 5.39% to 5.61%.

Third tier. For the third tier, the credit union would pay $841.45 and $5,871.78 in dividends on the low end of the third tier (a balance of $15,000.01). For $15,000.01, dividends would be figured on $2,500 at 5.25% dividend rate, plus dividends on $12,500 at 5.50% dividend rate, plus dividends on $.01 at 5.75% dividend rate. For the low end of the third tier, therefore, the annual percentage yield, using the simple formula, is 5.61%:

APY = 100 (841.45/15,000)

APY = 5.61%

Assuming the credit union does not limit the account balance, it may assume any maximum amount for the purposes of computing the annual percentage yield for the high end of the third tier. For an assumed maximum balance amount of $100,000, dividends would be figured on $2,500 at 5.25% dividend rate, plus dividends on $12,500 at 5.50% dividend rate, plus dividends on $85,000 at 5.75% dividend rate. For the high end of the third tier, therefore, the annual percentage yield, using the simple formula, is 5.87%:

APY = 100 (5,871.78/100,000)

APY = 5.87%

Thus, the annual percentage yield that would be stated for the third tier is 5.61% to 5.87%. If the assumed maximum balance amount is $1,000,000, credit unions would use $985,000 rather than $85,000 in the last calculation. In that case for the high end of the third tier, the annual percentage yield, using the simple formula, is 5.91%:

APY = 100 (59,134.22/1,000,000)

APY = 5.91%

Thus, the annual percentage yield range that would be stated for the third tier is 5.61% to 5.91%.

E. Term Share Accounts with a Stated Maturity Greater than One Year that Pay Dividends At Least Annually

1. For term share accounts with a stated maturity greater than one year, that do not compound dividends on an annual or more frequent basis, and that require the member to withdraw dividends at least annually, the annual percentage yield may be disclosed as equal to the dividend rate.

EXAMPLE

If a credit union offers a $1,000 two-year term share account that does not compound and that pays out dividends semi-annually by check or transfer at a 6.00% dividend rate, the annual percentage yield may be disclosed as 6.00%.

2. For term share accounts covered by this paragraph that are also stepped-rate accounts, the annual percentage yield may be disclosed as equal to the composite dividend rate.

EXAMPLE

(1) If a credit union offers a $1,000 three-year term share account that does not compound and

that pays out dividends annually by check or transfer at a 5.00% dividend rate for the first year, 6.00% dividend rate for the second year, and 7.00% dividend rate for the third year, the credit union may compute the composite dividend rate and APY as follows:

(a) Multiply each dividend rate by the number of days it will be in effect;

(b) Add these figures together; and

(c) Divide by the total number of days in the term.

(2) Applied to the example, the products of the dividend rates and days the rates are in effect are (5.00%×365 days) 1825, (6.00%×365 days) 2190, and (7.00%×365) 2555, respectively. The sum of these products, 6570, is divided by 1095, the total number of days in the term. The composite dividend rate and APY are both 6.00%.

Part II. Annual Percentage Yield Earned for Statements

The annual percentage yield earned for statements under § 707.6 is an annualized rate that reflects the relationship between the amount of dividends actually earned (accrued or paid and credited) to the member's account during the period and the average daily balance in the account for the period over which the dividends were earned.

Pursuant to § 707.6(a), when dividends are paid less frequently than statements are sent, the APY Earned may reflect the number of days over which dividends were earned rather than the number of days in the statement period, e.g., if a credit union uses the average daily balance method and calculates dividends for a period other than the statement period, the annual percentage yield earned shall reflect the relationship between the amount of dividends earned and the average daily balance in the account for the other period, such as a crediting or dividend period.

The annual percentage yield shall be calculated by using the following formulas ("APY Earned" is used for convenience in the formulas):

A. General formula

$$\text{APY Earned} = 100[(1 + \text{Dividends earned/Balance})^{(365/\text{Days in period})} - 1]$$

"Balance" is the average daily balance in the account for the period.

"Dividends earned" is the actual amount of dividends accrued or paid and credited to the account for the period.

"Days in period" is the actual number of days over which the dividends disclosed on the statement were earned.

EXAMPLES:

(1) If a credit union calculates dividends for the statement period (and uses either the daily balance or the average daily balance method), and the account had a balance of $1,500 for 15 days and a balance of $500 for the remaining 15 days of a 30-day statement period, the average daily balance for the period is $1,000. Assume that $5.25 in dividends was earned during the period. The annual percentage yield earned (using the formula above) is 6.58%:

$$\text{APY Earned} = 100\ [(1 + 5.25/1{,}000)^{(365/30)} - 1]$$

APY Earned = 6.58%

(2) Assume a credit union calculates dividends on the average daily balance for the calendar month and provides periodic statements that cover the period from the 16th of one month to the 15th of the next month. The account has a balance of $2,000 September 1 through September 15 and a balance of $1,000 for the remaining 15 days of September. The average daily balance for the month of September is $1,500, which results in $6.50 in dividends earned for the month. The annual percentage yield earned for the month of September would be shown on the periodic statement covering September 16 through October 15. The annual percentage yield earned (using the formula above) is 5.40%:

$$\text{APY Earned} = 100\ [(1 + 6.50/1{,}500)^{(365/30)} - 1]$$

APY Earned = 5.40%

(3) Assume a credit union calculates dividends on the average daily balance for a quarter (for example, the calendar months of September through November), and provides monthly periodic statements covering calendar months. The account has a balance of $1,000 throughout the 30 days of September, a balance of $2,000 throughout the 31 days of October, and a balance of $3,000 throughout the 30 days of November. The average daily balance for the quarter is $2,000, which results in $21 in dividends earned for the quarter. The annual percentage yield earned would be shown on the periodic statement for November. The annual

percentage yield earned (using the formula above) is 4.28%:

$$\text{APY Earned} = 100\,[(1 + 21/2{,}000)^{(365/91)} - 1]$$

APY Earned = 4.28%

B. Special formula for use where periodic statement is sent more often than the period for which dividends are compounded.

Credit unions that use the daily balance method to accrue dividends and that issue periodic statements more often than the period for which dividends are compounded shall use the following special formula:

$$\text{APY Earned} = 100\left[\left(1 + \frac{(\text{Dividends earned/Balance})}{\text{Days in period (Compounding)}}\right)^{(365/\text{Compounding})} - 1\right]$$

The following definition applies for use in this formula (all other terms are defined under Part II):

"Compounding" is the number of days in each compounding period.

Assume a credit union calculates dividends for the statement period using the daily balance method, pays a 5.00% dividend rate, compounded annually, and provides periodic statements for each monthly cycle. The account has a daily balance of $1,000.00 for a 30-day statement period. The dividend earned of $4.11 for the period, and the annual percentage yield earned (using the special formula above) is 5.00%:

$$\text{APY Earned} = 100\left[\left(1 + \frac{(\$4.11/1{,}000)}{30}(365)\right)^{(365/365)} - 1\right]\%$$

Appendix B to Part 707—Model Clauses and Sample Forms

General Note: Appendix B contains model clauses and sample forms intended for optional use by credit unions to aid in compliance with the disclosure requirements of §§ 707.4 (account disclosures), 707.5 (subsequent disclosures), 707.6 (statement disclosures), and 707.8 (advertisements). Section 269(b) of TISA provides that credit unions that use these clauses and forms will be in compliance with TISA's disclosure provisions.

As discussed in the supplementary information to § 707.3(a), this final rule provides for flexibility in designing the format of the disclosures. Credit unions can choose to prepare a single document or brochure that incorporates disclosures for all accounts offered, or to prepare different documents for each type of account. Credit unions may also use inserts to a document, or fill in blanks to show current rates, fees and other terms.

In the model clauses, words in parentheses indicate the type of disclosure a credit union should insert in the space provided (for example, a credit union might insert "July 23, 1995" in the blank for a "(date)" disclosure). Brackets and "/" indicate that a credit union must choose the alternative that best describes its practice (for example, "[daily balance/ average daily balance]"). It should be noted that only in sections B–6 through B–10 of this appendix have specific examples of disclosures been given, with dates and figures. Sections B–1 through B–5, and section B–11 provide only unspecific model clauses or blank forms. The Board felt, as did the FRB in the Appendix A to Regulation DD, that a mix of blank clauses and forms and application of the model clauses to real specific situations would benefit those who must comply with TISA.

Any references to NCUA Rules and Regulations, the *NCUA Standard FCU Bylaws,* or the *NCUA Accounting Manual for FCUs,* are provided for guidance and as a point of reference for credit unions. Citations to these sources does not indicate that their application is required for those credit unions who need not follow them.

B–1 MODEL CLAUSES FOR ACCOUNT DISCLOSURES (§ 707.4(b))

(a) Rate Information (Sec.707.4(b)(1))

(i) *Fixed-Rate Accounts (§ 707.4(b)(1)(i)(A–B))*

1. Interest-bearing Accounts

The interest rate on your deposit account is _____% with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

Note: This provision reflects an accurate statement for an interest-bearing account authorized by state law for state-chartered credit unions. While the definition of the term "interest" permits its substitution for the term "dividends," separate disclosures should be made for interest-bearing accounts. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Given the definition of fixed-rate account in § 707.2(n), credit unions offering fixed-rate accounts must contract to hold rates steady for at least a 30-day period. Thus, if the 30-day option of the last sentence is not chosen, the period chosen must be longer than 30 days.

2. Dividend-bearing Term Share Accounts

The dividend rate on your term share account is _____% with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

Note: This provision reflects an accurate statement for a fixed-rate, dividend-bearing

term share account. Interest-bearing term share accounts would use the disclosure in § 1, above. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Given the definition of fixed-rate account in § 707.2(n), credit unions offering fixed-rate accounts must contract to hold rates steady for at least a 30-day period. Thus, if the 30-day option of the last sentence is not chosen, the period chosen must be longer than 30 days.

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/(date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with a prospective APY of _____% for the current dividend period.] You will be paid this rate for [(time period)/at least 30 calendar days].

or

[As of [the last dividend declaration date/(date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with an annual percentage yield (APY) of _____% for this dividend period.] This rate will not change unless the credit union notifies you at least 30 calendar days prior to any change.

Note: Credit unions may disclose the dividend rate and annual percentage yield on accounts as of the last dividend declaration date. This necessitates inclusion of a disclosure of the actual calendar date of the last dividend declaration date. Additionally or alternatively (if the last dividend rate could be inaccurate), credit unions may disclose a prospective dividend rate and a prospective annual percentage yield. Such prospective rates and yields must be estimated in good faith, and must be declared at the proper time if it is at all possible to do so. As for the last sentence in these disclosures, this provision reflects a credit union policy to set prospective dividend rates for the next month (or at least 30 days), quarter or other period. Many credit unions, at their mid-monthly board meeting, set prospective dividend rates for the next month beginning on the 1st day of the month and continuing to the last day of the month. These rates must be formalized or ratified at the end of a dividend period. Given the timing of the board meetings, the time to prepare and mail notices and the 30 day period, it will often take credit unions 45 to 60 days to effectively change rates. For these reasons, the Board strongly suggests that credit unions do not offer fixed-rate, dividend-bearing accounts.

(ii) Variable-Rate Accounts (§ 707.4(b)(1)(ii))

1. Interest-bearing Accounts

The interest rate on your deposit account is _____%, with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] The interest rate and annual percentage yield may change every (time period) based on [(name of index)/the determination of the credit union board of directors]. The interest rate for your account will [never change by more than _____% each (time period)/never be less/more than _____%/never exceed _____% above or fall more than _____% below the initial interest rate].

Note: This disclosure combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii) for interest-bearing accounts. The variable nature of a deposit account usually is based on an external index or is set at the discretion of the board. If another means of rate setting is used, that, instead of the proposed language, must be disclosed. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Rarely would there be limitations on rate changes, but language is provided for this situation in the last sentence. Of

course, it is only to be used if it applies to an account.

2. Dividend-bearing Term Share Accounts

The dividend rate on your term share account is _____%, with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] The dividend rate and annual percentage yield may change every (time period) based on [(name of index)/the determination of the credit union board of directors]. The dividend rate for your account will [never change by more than _____% each (time period)/never be less/more than _____%/never exceed _____% above or fall more than _____% below the initial dividend rate].

Note: This disclosure combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii) for dividend-bearing, variable-rate term share accounts. The variable nature of a deposit account usually is based on an external index or is set at the discretion of the board. If another means of rate setting is used, that, instead of the model language, must be disclosed. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Rarely would there be limitations on rate changes, but language is provided for this situation in the last sentence. Of course, it is only to be used if it applies to an account.

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/(date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with an anticipated annual percentage yield (APY) of _____% for the current dividend period.] The dividend rate and annual percentage yield may change every (dividend period) as determined by the credit union board of directors.

Note: This language combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii). Credit unions may disclose the dividend rate and annual percentage yield on accounts as of the last dividend declaration date. This necessitates inclusion of a disclosure of the actual calendar date of the last dividend declaration date or use of the phrase "last dividend declaration date". Additionally or alternatively, credit unions may disclose a prospective dividend rate and a prospective annual percentage yield. Such prospective rates and yields must be estimated in good faith, and must be declared at the proper time if it is at all possible to do so. As for the last sentence in these disclosures, this provision reflects the variable nature of the account. Generally, there is only one variable-rate feature for share accounts: the frequency of dividend period rate changes (e.g., daily, weekly, monthly, quarterly, semi-annually, annually). Normally, there are no contractual limitations on share account earnings (unless imposed by a regulator), nor are earnings based on any internal or external index. If contractual limitations or an index are involved, however, those factors would need to be disclosed (unless a regulator orders otherwise).

(iii) Stepped-Rate Accounts (§ 707.4(b)(1)(i))

1. Interest-bearing Accounts

The initial interest rate on your deposit account is _____%. You will be paid that rate [for (time period)/until (date)]. After that time, the interest rate for your deposit account will be _____% and you will be paid that rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

2. Dividend-bearing Term Share Accounts

The initial dividend rate on your term share account is _____%. You will be paid that rate [for (time period)/until (date)]. After that time, the dividend rate for your term share account will be _____% and you

will be paid that rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/(date)], the initial dividend rate on your account was _____%./or The prospective dividend rate on your account is _____%.] You will be paid that rate [for (time period)/until (date)]. After that time, the prospective dividend rate for your share account will be _____% and you will be paid such rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. You will be paid this rate for [(time period)/at least 30 calendar days].

Note: Stepped-rate accounts are accounts with two or more rates that take effect in succeeding periods. The applicable rates and time periods are known when the account is opened. By nature these are fixed-rate accounts and are usually associated with term share (certificate) accounts. Accordingly, a contract provision (for share accounts) to change rates should be included.

(iv) Tiered-Rate Accounts (§ 707.4(b)(1)(i))

1. Interest-bearing Accounts

Tiering Method A

1* If your [daily balance/average daily balance] is $ _____ or more, the interest rate paid on the entire balance in your account will be _____%, with an annual percentage yield (APY) of _____%.

2* If your [daily balance/average daily balance] is more than $ _____, but less than $ _____, the interest rate paid on the entire balance in your account will be _____%, with an APY of _____%.

3* If your [daily balance/average daily balance] is $ _____ or less, the interest rate paid on the entire balance will be _____% with an APY of _____%.

[For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./*Variable-rate*—The interest rate and APY may change every (time period) based on [(name of index)/the determination of the credit union board of directors.]

Note: Tiering Method A pays the stated dividend rate that corresponds to the applicable account balance tier on the full balance in the account. This example contemplates a two-tier system. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currency of the rate, as is provided in the first set of brackets. A disclosure regarding the fixed-rate or variable-rate nature of the account must be added, as is provided in the last set of brackets.

Tiering Method B

1* A dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

2* A dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____, but less than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

3* If your [daily balance/average daily balance] is $_____ or less, the dividend rate paid on the entire balance will be _____%, with an annual percentage yield (APY) of _____%.

[For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./*Variable-rate*—The interest

rate and APY may change every (time period) based on [(name of index)/the determination of the credit union board of directors.]

Note: Tiering Method B pays different stated dividend rates corresponding to applicable deposit tiers, on the applicable balance in each tier of the account. For example, a credit union might pay 3% dividend on account funds of $500 or below, and pay 4% dividend on the portion of the same account that exceeds $500. The example contemplates an account with two tiers, but additional tiers are possible. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currentness of the rate, as is provided in the first set of brackets.

Tiered-rate accounts can be either fixed-rate or variable-rate accounts. The last sentence offers an option of either fixed-rate or variable-rate disclosure. Thus, the disclosures outlined above will be made in addition to either: (i) disclosure of the period the fixed-rates are in effect or (ii) the variable-rate disclosures. Tiered-rate accounts are also subject to the requirement for disclosure of the balance computation method, *see* paragraph (e) to this appendix.

2. Dividend-bearing Term Share Accounts

Tiering Method A

1* If your [daily balance/average daily balance] is $_____ or more, the dividend rate paid on the entire balance in your account will be _____%, with an annual percentage yield (APY) of _____%.

2* If your [daily balance/average daily balance] is more than $_____, but less than $_____, the dividend rate paid on the entire balance in your account will be _____%, with an APY of _____%.

3* If your [daily balance/average daily balance] is $_____ or less, the dividend rate paid on the entire balance will be _____% with an APY of _____%.

[For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./ *Variable-rate*—The interest rate and APY may change every (time period) based on [(name of index)/ the determination of the credit union board of directors.]

Note: Tiering Method A pays the stated dividend rate that corresponds to the applicable account balance tier on the full balance in the account. This example contemplates a two-tier system. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currency of the rate, as is provided in the first set of brackets. A disclosure regarding the fixed-rate or variable-rate nature of the account must be added, as is provided in the last set of brackets.

Tiering Method B

1* A dividend rate of _____% will be paid only on the portion of your [daily balance/ average daily balance] that is greater than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

2* A dividend rate of _____% will be paid only on the portion of your [daily balance/ average daily balance] that is greater than $_____, but less than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

3* If your [daily balance/average daily balance] is $_____ or less, the dividend rate paid on the entire balance will be _____%, with an annual percentage yield (APY) of _____%.

[For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./ *Variable-rate*—The interest rate and APY may change every (time period) based on [(name of index)/ the determination of the credit union board of directors.]

Note: Tiering Method B pays different stated dividend rates corresponding to applicable account balance tiers, on the applicable balance in each tier of the account. For example, a credit union might pay 3% dividend on account funds

of $500 or below, and pay 4% dividend on the portion of the same account that exceeds $500. The example contemplates an account with two tiers, but additional tiers are possible. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currentness of the rate, as is provided in the first set of brackets.

Tiered-rate accounts can be either fixed-rate or variable-rate accounts. The last sentence offers an option of either fixed-rate or variable-rate disclosure. Thus, the disclosures outlined above will be made in addition to either: (i) Disclosure of the period the fixed-rates are in effect or (ii) the variable-rate disclosures. Tiered-rate accounts are also subject to the requirement for disclosure of the balance computation method, *see* paragraph (e) to this appendix.

3. Other Dividend-bearing Accounts

Tiering Method A

1* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or more, the dividend rate paid on the entire balance in your account was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is $_____ or more, a prospective dividend rate of _____% will be paid on the entire balance in your account with a prospective annual percentage yield (APY) of _____% for this dividend period.]

2* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was more than $_____, but was less than $_____, the dividend rate paid on the entire balance in your account was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is more than $_____, but is less than $_____, a prospective dividend rate of _____% will be paid on the entire balance in your account with a prospective annual percentage yield (APY) of _____% for this dividend period.]

3* [As of the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or less, the dividend rate paid on the entire balance in your account will be _____% with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is $_____ or less, the prospective dividend rate of_____% will be paid on the entire balance in your account with an annual percentage yield (APY) of _____% for this dividend period.]

[*Fixed-rate*—You will be paid this rate for [(time period)/at least 30 calendar days]./ *Variable-rate*—The dividend rate and APY may change every (dividend period) as determined by the credit union board of directors.]

Note: Tiering Method A pays the stated dividend rate that corresponds to the applicable deposit tier on the full balance in the account. This example contemplates a two-tier system. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the prospective rate. Note that the prospective rate disclosure options match the required tiered-rate disclosures based on the previous dividend declaration date. A disclosure regarding the fixed-rate or variable-rate nature of the account must be added, as is provided in the last set of brackets.

Tiering Method B

1* [As of [the last dividend declaration date/(date)], a dividend rate of _____% was paid only on the portion of your [daily balance/average daily balance] that was greater than $_____. The annual percentage yield (APY) for this tier ranged from _____% to _____%, depending on the balance in the account./or A prospective dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____ with a prospective annual percentage yield (APY) ranging from _____% to _____%, depending on the balance in the account, for this dividend period.]

2* [As of [the last dividend declaration date/(date)], a dividend rate of _____% was paid only on the portion of your [daily balance/average daily balance] that was greater than $_____ but less than $_____. The annual percentage yield (APY) for this tier ranged from _____% to _____%, depending on the balance in the account./or A prospective dividend rate of _____% will be paid only on the portion of your [daily balance/average daily

balance] that is greater than $_____, but less than $_____] with a prospective annual percentage yield (APY) ranging from _____% to _____%, depending on the balance in the account, for this dividend period.]

3* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or less, the dividend rate paid on the entire balance was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] was $_____ or less, the prospective dividend rate paid on the entire balance in your account will be _____% with a prospective annual percentage yield (APY) of _____% for this dividend period.]

Note: Tiering Method B pays different stated dividend rates corresponding to applicable account tiers, on the applicable balance in each tier of the account. For example, a credit union might pay a 3% dividend on account funds of $500 or below, and pay a 4% dividend on the portion of the same account that exceeds $500. The example contemplates an account with two tiers, but additional tiers are possible. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. Note that the prospective rate disclosure options match the required tiered-rate disclosures based on the previous dividend declaration date.

Tiered-rate accounts can be either fixed-rate or variable-rate accounts. The last sentence offers an option of either fixed-rate or variable-rate disclosures. Thus, the disclosures outlined above must be made in addition to either: (i) disclosure of the period the fixed-rates are in effect or (ii) the variable-rate disclosures. Tiered-rate accounts are also subject to the requirement for disclosure of the balance computation method, *see* paragraph (e) to this appendix.

(b) Nature of Dividends (§ 707.4(b)(8))

Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

Note: The Board of Directors declares dividends based on current income and available earnings of the credit union after providing for the required reserves at the end of the month. The dividend rate and annual percentage yield shown may reflect either the last dividend declaration date on the account or the earnings the credit union anticipates having available for distribution. This disclosure only applies to share and share draft (as opposed to deposit) accounts and should be grouped with the Rate Information to make the disclosures more meaningful. This disclosure also does not apply to term share accounts for reasons discussed in the supplementary information regarding §§ 707.3(e) and 707.4(b)(8).

(c) Compounding and Crediting (§ 707.4(b)(2))

[Dividends/Interest] will be compounded (frequency) and will be credited (frequency).

and, if applicable:

If you close your [share/deposit] account before [dividends/interest] [are/is] paid, you will not receive the accrued [dividends/interest].

and, if applicable (for dividend-bearing accounts):

For this account type, the dividend period is (frequency), for example, the beginning date of the first dividend period of the calendar year is (date) and the ending date of such dividend period is (date). All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example is (date).

Note: Where the word "(frequency)" appears, time periods must be inserted to coincide with those specified in board resolutions of each credit union's board of directors. A disclosure of dividend period was added to § 707.4(b)(2)(i) in the final rule to assist members in knowing when dividend rate and APY disclosures would be given by a credit union using the optional statement rule of § 707.6(a). The dividend declaration date is important for purposes of § 707.4(a)(2)(ii), request disclosures, § 707.4(b)(2), account opening disclosures, and § 707.8(c)(2), advertising disclosures. The Board believes that this is critical information for dividend-bearing accounts, but that provision by an example (whether of the first dividend period of the year, or of any randomly chosen dividend period) is favorable to providing a list of such dates for the entire year or for a period of years (although these methods would also be permissible). As noted in the supplementary information to § 707.2(j), dividend declaration date, the dividend period and actual dividend distribution date may vary. Thus, it is possible for crediting

periods and dividend periods not to coincide, though the Board believes that credit unions should make every effort to attempt to coordinate the two periods.

(d) Minimum Balance Requirements (§ 707.4 (b)(3)(i))

(i) *To open the account*

The minimum balance required to open this account is $_____.

or, for first share account at a credit union

The minimum required to open this account is the purchase of a (par value of a share) share in the credit union.

(ii) *To avoid imposition of fees*

You must maintain a minimum daily balance of $_____ in your account to avoid a service fee. If, during any (time period), your account balance falls below the required minimum daily balance, your account will be subject to a service fee of $_____ for that (time period).

or

You must maintain a minimum average daily balance of $_____ in your account to avoid a service fee. If, during any (time period), your average daily balance is below the required minimum, your account will be subject to a service fee of $_____ for that (time period).

(iii) *To obtain the annual percentage yield disclosed*

You must maintain a minimum daily balance of $_____ in your account each day to obtain the disclosed annual percentage yield.

or

You must maintain a minimum average daily balance of $_____ in your account to obtain the disclosed annual percentage yield.

(iv) *Absence of minimum balance requirements*

No minimum balance requirements apply to this account.

(v) *Par value*

The par value of a share in this credit union is $_____.

Note: Where the words "(time period)" appear, time periods should be inserted to coincide with those specified in board resolutions of each credit union's board of directors. As the supplementary information to § 707.4(b)(3)(i) explains, the par value of a share to establish membership is a critical disclosure to be made to potential members of credit unions. The par value disclosure is required by § 707.4(b)(3)(i) as being analogous to a minimum balance account opening requirement.

(e) Balance Computation Method (§ 707.4(b)(3)(ii))

(i) *Daily Balance Method*

[Dividends/Interest] [are/is] calculated by the daily balance method which applies a daily periodic rate to the balance in the account each day.

(ii) *Average Daily Balance Method*

[Dividends/Interest] [are/is] calculated by the average daily balance method which applies a periodic rate to the average daily balance in the account for the period. The average daily balance is calculated by adding the balance in the account for each day of the period and dividing that figure by the number of days in the period.

Note: Any explanation of balance computation method must contain enough information for members to grasp the means by which dividends or interest will be calculated on their accounts. Using a shorthand form, such as "day in/day out" for the daily balance method or "average balance" for the average daily balance method, without more information, is insufficient. In addition, any disclosure based on the equivalency of the two allowable methods, such as stating that the average daily balance method was the same as the daily balance method, is impermissible and misleading.

(f) Accrual of Dividends/Interest on Noncash Deposits (§ 704.4(b)(3)(iii))

[Dividends/Interest] will begin to accrue on the business day you [place/deposit] noncash items (e.g. checks) to your account.

or

[Dividends/Interest] will begin to accrue no later than the business day we receive provisional credit for the [placement/deposit] of noncash items (e.g. checks) to your account.

Note: Accrual information is not included in the explanation of balance computation method required by § 707.4(b)(4)(ii). In addition, the disclosures required by TISA do not affect the substantive requirements of the EFAA and Regulation CC. The EFAA and Regulation CC control,

and any modifications to them should occasion credit unions to revisit this disclosure with a view to revising it to reflect current law.

(g) Fees and Charges (§ 707.4(b)(4))

The following fees and charges may be assessed against your account:
(service/explanation) $_____
(service/explanation) $_____

Note: Fees and charges may be disclosed in an account disclosure, or separately in a Rate and Fee Schedule (see section B–11 of this appendix). In either event, the disclosure should also specify when the fee will be assessed by using phrases such as "per item," "per month," or "per inquiry."

(h) Transaction Limitations (§ 707.4(b)(5))

The minimum amount you may [withdraw/write a draft for] is $_____.

During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to [closure by the credit union/a fee of $_____].

Note: This paragraph satisfies the requirements of § 707.4(b)(6) with respect to Regulation D limitations on share accounts and money market accounts. These are some of the more common limitations applicable.

The credit union reserves the right to require a member intending to make a withdrawal from any account (except a share draft account) to give written notice of such intent not less than seven days and up to 60 days before such withdrawal.

Note: This disclosure is limted to federal credit unions with Bylaws containing this limitation. See Standard Federal Credit Union Bylaws, Art. III, § 5(a). Similar disclosures are required of any state-chartered credit unions having similar limitations in their bylaws, or under state law. This limitation does not directly relate to the "number" or "amount" of transactions, and accordingly, may not be necessary under § 707.4(b)(5), but would, if applicable, be required by § 707.3(b).

(i) Disclosures related to term share accounts (§ 707.4(b)(6))

(i) *Time requirements*

Your account will mature on (date).

or

Your account will mature after (time period).

(ii) *Early withdrawal penalties*

We [will/may] impose a penalty if you withdraw [any/all] of the [funds/principal] in your account before the maturity date. The penalty will equal [_____ days'/weeks'/months'] [dividends/interest] on your account.

or

We [will/may] impose a penalty of $_____ if you withdraw [any/all] of the [funds/principal] before the maturity date.

If you withdraw some of your funds before maturity, the [dividend/interest] rate for the remaining funds in your account will be _____%, with an annual percentage yield of _____%.

Note: In most cases, the dividend rate and annual percentage yield on the funds remaining in the account after early withdrawal are the same as before the withdrawal. Accordingly, the disclosure of dividend rate and annual percentage yield after withdrawal is required only if the dividend rate and APY will change.

(iii) *Withdrawal of dividends/interest prior to maturity*

The annual percentage yield is based on an assumption that [dividends/interest] will remain in the account until maturity. A withdrawal will reduce earnings.

Note: This disclosure may be used if the credit union compounds dividends/interest and allows withdrawal of accrued dividends/interest before maturity. This disclosure alerts members that the annual percentage yield is based on an assumption that the dividends/interest remain on deposit until maturity.

(iv) *Renewal policies*

1. *Automatically renewable term share accounts*

Your term share account will automatically renew at maturity. You will have a grace period of _____ [calendar/business] days after the maturity date to withdraw the funds in the account without being charged an early withdrawal penalty.

or

Your term share account will automatically renew at maturity. There is no grace period following the maturity of this account.

2. *Non-automatically renewable term share accounts*

This account will not renew automatically at maturity. If you do not renew the account, your account will [continue to earn/ no longer earn] [dividends/interest] after the maturity date.

Note: These disclosures should agree with the necessary prematurity notices for term share accounts in B–3 of this appendix.

(v) *Required dividend distribution.*

This account requires the distribution of dividends and does not allow dividends to remain in the account.

(j) Bonuses (§ 704.4(b)(7))

You will [be paid/receive] [$_____/ (description of item)] as a bonus [when you open the account/on (date)].

You must maintain a minimum [daily balance/ average daily balance] of $_____ to obtain the bonus.

To earn the bonus, [$_____/your entire principal] must remain on deposit [for (time period)/until (date)].

Note: These disclosures follow the requirements of § 707.4(b)(7) and should be used as applicable. Further information may also be added, especially if it clarifies the conditions and timing of receiving the bonus, or better informs the member about the bonus.

B–2 MODEL CLAUSES FOR CHANGES IN TERMS (§ 707.5(a))

On (date), the (type of fee) will increase to $_____. On (date), the [dividend/interest] rate on your account will decrease to _____%, with an annual percentage yield (APY) of _____%.

On (date), the [minimum daily balance/ average daily balance] required to avoid imposition of a fee will increase to $_____.

Note: These examples apply to the more common changes necessitating a changes in terms notice. However, any change, amendment or modification reducing the APY or adversely affecting the members holding such accounts must be disclosed. For such changes not contemplated by the model clauses, the Board recommends the use of as simple language as possible to convey the change, along with cross-referencing to the particular sections or paragraph numbers of the account opening disclosures, when to do so will assist members in reviewing and understanding the change.

B–3 MODEL CLAUSES FOR PRE-MATURITY NOTICES FOR TERM SHARE ACCOUNTS (§ 707.5(b–d))

(a) *Maturity date*

Your term share account will mature on _____.

(b) *Nonrenewal*

Unless your term share account is renewed, it will not accrue further [dividends/ interest] after the maturity date.

(c) *Rate information*

The [dividend/interest] rate and annual percentage yield that will apply to your term share account if it is renewed have not yet been determined. That information will be available on _____. After that date, you may call the credit union during regular business hours at (telephone number) to find out the [dividend/interest] rate and annual percentage yield (APY) that will apply to your term share account if it is renewed.

Note: Pre-maturity notices should follow the requirements of § 707.5(b–d) as closely as possible. Care should be taken to explain any grace periods used. See discussion of use of alternative timing in supplementary information to § 707.2(o) and § 707.5(b–d).

B–4 SAMPLE FORM (SIGNATURE CARD/ APPLICATION FOR MEMBERSHIP)

SIGNATURE CARD/APPLICATION FOR MEMBERSHIP

ACCOUNT NUMBER _____

_____ _____ _____
(last name) (first name) (middle name)

_____ _____
(street address) (apartment no.)

_____ _____ _____
(city) (state) (zip code)

_____ _____
(home telephone no.) (business telephone no.)

_____ _____
(Social Security # or TIN) (date of birth)

_____ _____
(mother's maiden name) (employer, occupation)

I hereby make application for membership in and agree to conform to the Bylaws, as amended, of _____ Credit Union (the "Credit Union"). I certify that: I am within the field of membership of this Credit Union; the information provided on this application is true and correct; and my signature on this card applies to all accounts under my name at this Credit Union. I also agree to be bound to the terms and conditions of any account that I have in the Credit Union now or in the future.

_____
(signature of applicant)

This application approved _____ (date) by the (Check one)
( ) Board ( ) Exec. Committee ( ) Membership Officer
Signed: _____
(Secretary; Exec. Cmte. Member, or Membership Officer)

Note: This form is modeled on NCUA Form FCU 150, Application for Membership, as discussed in the Accounting Manual for FCUs, §§ 5030.1, 5150.3. It is noted that other information can also be requested on the signature card, as long as it is in accordance with federal and state laws. For example, information identifying the member, such as a state driver's license number, could be added. The types of accounts that the signature applies to could be specified. Furthermore, the Board notes that this card contains much identification information that may not be necessary for all credit unions; common sense should guide credit union boards of directors in designing their applications for membership/signature cards. However, the Board believes that the information solicited on this form is reasonable and prudent for many credit unions. Payable on death designations, joint account language required under state law, life savings beneficiary designations, and other like variations and designations may be added to the card if so desired. The proposed signature card/ application for membership form contained taxpayer certification language. One commenter noted that the IRS may always change its requirements in this area, which are beyond the authority of the Board. Therefore, the Board has deleted reference to the IRS taxpayer certification required by 26 USC 3406, but notes that such certification must be made in accordance with applicable law and IRS rules. The information may be included on the front and back of a standard size signature card, or on the front of a large size signature card. However, no account terms may be included on a signature card unless a copy of the signature card is provided to the member at the time of account opening. The Board recommends that credit unions refrain from this practice, and instead use standard account disclosures. One reason for this is that if laws, regulations or credit union policies change, discrepancies may result between them and the earlier signature card terms. Given the longevity of credit union membership, signature cards may well be in use for up to or over a century. In addition, as signature cards are relatively small, they probably will not contain enough space to make all desired and required disclosures. Fragmentation of terms, some on signature cards, some on separate disclosures, could easily lead to member confusion. As terms are usually construed against the drafter, credit unions should be very careful in their use of account terms and conditions varying from those provided as model clauses and sample forms in this appendix.

B–5 SAMPLE FORM (TERM SHARE [CERTIFICATE] ACCOUNT)

TERM SHARE (CERTIFICATE) ACCOUNT

_____ _____
Date Issued Account Number

_____ _____
Certificate Number Social Security Number

This is to certify that (name(s)) _____ [is/are] the owner(s) of a term share certificate account in the _____ Credit Union (the "Credit Union") in the amount of _____ Dollars ($_____). This term share certificate account may be redeemed on (maturity date) _____ only upon presentation of the certificate to the Credit Union. The dividend rate of this certificate account is _____% with an annual percentage yield of _____%. The annual percentage yield and dividend rate assume that dividends are to be [check one] ( ) added to principal/ ( ) paid to regular share account number _____/( ) mailed to owner(s). This account is subject to all terms and conditions stated in the Term Share Certificate Account Disclosures, as they may be amended from time to time, and incorporates the same by reference into this agreement.

_____
Authorized signature

_____
Authorized signature

Note: This form is modeled on NCUA Form FCU 107SCP, Credit Union Share Certificate, as discussed in the Accounting Manual for FCUs, §§ 5030.1, 5150.6. It is simplified to reflect the term share (certificate) account agreement, the parties involved, the maturity term and the annual percentage yield and dividend rate. All other terms are incorporated by reference. This should allow the credit union maximum flexibility in fashioning certificate, and other term share account, products. If a credit union so desired, other terms and conditions could be incorporated into the term share certificate itself, as long as a copy is presented to the member at the account opening. Care should also be taken to ensure that the term share certificate format addresses any necessary state law concerns. As the FRB's Regulation D on reserve requirements permits all term share accounts to be represented by a transferable or nontransferable, or a negotiable or nonnegotiable, certificate, instrument, passbook, statement or otherwise, and still be considered a "time deposit", the Board has made no entry on this sample form regarding such terms, leaving the decision instead to each credit union's board of directors. 12 CFR 202.4(c)(2).

B–6 SAMPLE FORM (REGULAR SHARE ACCOUNT DISCLOSURES)

REGULAR SHARE ACCOUNT DISCLOSURES

1. *Rate information.* As of April 1, 1995, the dividend rate was 5.00% and the annual percentage yield (APY) was 5.13% on your regular share account. In addition, the credit union estimates a prospective dividend rate of 5.25% and a prospective APY of 5.39% on your share account for this dividend period. The divident rate and annual percentage yield may change every quarter as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded daily and will be credited quarterly. For this account type, the dividend period is quarterly, for example, the beginning date of the first dividend period of the calendar year is January 1 and the ending date of such dividend period is March 31. All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example is April 1. If you close your regular share account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance to open this account is the purchase of a $5 share in the Credit Union. You must maintain a minimum daily balance of $500 in your account to avoid a service fee. If, during any day during a quarter, your account balance falls below the required minimum daily balance, your account will be subject to a service fee of $5 for that quarter.

4. *Balance computation method.* Dividends are calculated by the daily balance method which applies a daily periodic rate to the principal in your account each day.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant account fee	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Minimum balance service fee.	$5.00 per quarter
f. Share transfer	$1.00 per transfer
g. Excessive share	$1.00 per item withdrawals

7. *Transaction limitations.* During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to closure by the credit union or to a fee of $1.00 per item.

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* A member who fails to complete payment of one share within

_____ of his admission to membership, or within _____ from the increase in the par value in shares, or a member who reduces his share balance below the par value of one share and does not increase the balance to at least the par value of one share within _____ of the reduction may be terminated from membership at the end of a dividend period. [All blanks should be filled with time chosen by credit union board of directors, but must be at least 6 months.] Shares may be transferred only from one member to another, by written instrument in such form as the Credit Union may prescribe. The Credit Union reserves the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the whole or any part of the amounts so paid in by them. No member may withdraw shareholdings that are pledged as required on security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the Credit Union. No member may withdraw any shareholdings below the amount of his/her primary or contingent liability to the Credit Union if he/she is delinquent as a borrower, or if borrowers for whom he/she is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or loan officer.

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $5. The dividend period of the Credit Union is quarterly.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [In this item, which may be titled or subdivided in any manner by each credit union, NCUA suggests that the following issues be covered or handled: statutory lien or setoff; expenses (garnishments and bankruptcy orders and holds on account); joint ownership accounts; trust accounts; payable-on-death accounts; retirement accounts; Uniform Transfer to Minor Act accounts; sole proprietorship accounts; escrow and custodial accounts; corporation accounts; not-for-profit corporation accounts; voluntary association accounts; partnership accounts; public unit accounts; powers of attorney (guardianship orders); tax disclosures and certifications; Uniform Commercial Code variances; amendments; reliance on signature card; change of address; incorporations of other documents by reference, such as expedited funds availability policies, service charges schedules or electronic banking disclosures; ability to suspend services; and operational matters (stop payment orders—verbal and written, satisfactory identification, refusal of deposits not in proper form, wire transfers, stale check deposits, availability of periodic statements or passbook feature.)]

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7. The disclosures are for a variable-rate, daily balance method dividend calculation regular share account in an FCU with a $500 minimum balance to avoid service fees. For the example, the account was opened on May 1, 1995. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. Item nos. 1–8 reflect standard TISA and part 707 disclosures discussed in sections B–1 through B–3 of this Appendix. Note that if the credit union limits the maximum amount of shares which may be held by one member under NCUA Standard FCU Bylaws, Art. III, § 2, that this should be stated in item no. 7, transaction limitations. Item no. 9 reflects various terms provided in Art. III, §§ 3–6 of the NCUA Standard FCU Bylaws. If this were a passbook account, then the requirements of Art. IV, Receipting for Money—Passbooks, in the NCUA Standard FCU Bylaws would also be included in item no. 9. Item no. 10 reflects the par value amount of regular shares in a federal credit union, pursuant to section 117 of the FCU Act, 12 USC 117, and Art. XIV, § 3 of the NCUA Standard FCU Bylaws. It also states the dividend period of the credit union, which is set by the board of directors. Item no. 11 addresses the requirements of 12 CFR part 740. Nonfederally insured credit unions (NICUs) would be expected to disclose information required by section 151 of the Federal Deposit Insurance Corporation Improvement Act of 1991. 12 USC 1831t. By December 19, 1992, all NICUs were required to include conspicuously on all periodic

statements of account, signature cards, passbooks, share certificates and other similar instruments of deposit and in all advertising a notice that the credit union is not federally insured. Additional disclosures will be required of NICUs by June 19, 1994. Item no. 12 is inserted to ensure that credit unions add other account terms and conditions not covered by the proposed regulation. These sorts of terms are contemplated by proposed § 707.3(b), requiring that the disclosures reflect the terms of the legal obligation between the member and the credit union. This list is not meant to be exhaustive, but to give a general idea of other topics often covered in share account contracts. Item no. 12 is not expressly required by either TISA or part 707, but any of these terms that are disclosed must be accurate and not misleading. Also the Board strongly recommends that such terms are included in account opening disclosures to inform the membership and to clearly set forth the legal relationship between the members and their credit union.

B–7 SAMPLE FORM (SHARE DRAFT ACCOUNT DISCLOSURES)

SHARE DRAFT ACCOUNT DISCLOSURES

1. *Rate information.* As of January 1, 1995, the dividend rate was 3.00% and the annual percentage yield (APY) was 3.04% on your share account. In addition, the prospective dividend rate on your account is 3.15% with a prospective annual percentage yield (APY) of 3.20% for the current dividend period. The dividend rate and APY may change every dividend period as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited monthly. For this account type, the dividend period is monthly, for example, the beginning date of the first dividend period of the calendar year is January 1 and the ending date of such dividend period is January 31. All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example above is February 1. If you close your share draft account before dividends are credited, you will not receive accrued dividends.

3. *No minimum balance requirements apply to this account.*

4. *Balance computation method.* Dividends are calculated by the average daily balance method which applies a periodic rate to the average daily balance in the account for the period. The average daily balance is calculated by adding the balance in the account for each day of the period and dividing that figure by the number of days in the period.

5. *Accrual of dividends.* Dividends will begin to accrue no later than the business day we receive provisional credit for the placement of noncash items (e.g. checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant account fee	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Overdrafts/Returned Items.	$5.00 per draft
f. Share transfer	$1.00 per transfer
g. Excessive share withdrawal.	$1.00 per item
h. Certified checks	$5.00 per check
i. Stop Payment Order ..	$5.00 per order
j. Check Printing Fee	$12.00 per 200 checks (varies depending on style of check ordered)

7. *No transaction limitations apply to this account.*

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* A member who fails to complete payment of one share within _____ of his admission to membership, or within _____ from the increase in the par value in shares, or a member who reduces his share balance below the par value of one share and does not increase the balance to at least the par value of one share within _____ of the reduction may be terminated from membership at the end of a dividend period. [All blanks should be filled with time chosen by credit union board of directors, but must be at least 6 months.] Shares may be transferred only from one member to another, by written instrument in such form as the Credit Union may prescribe. The Credit Union reserves the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the

whole or any part of the amounts so paid in by them. Shares paid in under an accumulated payroll deduction plan may not be withdrawn until credited to a member's account. No member may withdraw shareholdings that are pledged as required on security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the Credit Union. No member may withdraw any shareholdings below the amount of his/her primary or contingent liability to the Credit Union if he/she is delinquent as a borrower, or if borrowers for whom he/she is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or loan officer.

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $5. The dividend period of the Credit Union is monthly, beginning on the first of a month and ending on the last day of the month.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix].

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7. The disclosures are for a variable-rate, average daily balance method dividend calculation share draft account in an FCU with no minimum balance requirement. For purposes of this example, the account was opened on January 15, 1995. The Credit Union has monthly dividend periods. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. The disclosures are very similar to the ones in section B–6 of Appendix B, except for the rollback and par value disclosures, which have been removed from the final rule and appendices.

B–8 SAMPLE FORM (MONEY MARKET SHARE ACCOUNT DISCLOSURES)

MONEY MARKET SHARE ACCOUNT DISCLOSURES

1. *Rate information.* As of January 1, 1995, if your average daily balance was $500 or more, the dividend rate paid on the entire balance in your account was 4.75%, with an annual percentage yield (APY) of 4.85%. If your average daily balance is $500 or more, a prospective dividend rate of 4.95% will be paid on the entire balance in your account with a prospective APY of 5.00% for this dividend period on your account. The dividend rate and APY may change every dividend period as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited quarterly. If you close your share money market account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance required to open this account is $500. You must maintain a minimum daily balance of $500 in your account to avoid a service fee. If, during any (time period), your account falls below the required minimum daily balance, your account will be subject to a service fee of $5 for that (time period).

4. *Balance computation method.* Dividends are calculated by the average daily balance method which applies a periodic rate to the average daily balance in your account for the period. The average daily balance is calculated by adding the principal in the account for each day of the period and dividing that figure by the number of days in the period.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant accountee ...	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Minimum balance service fee.	$5.00 per time period
f. Share transfer	$1.00 per transfer
g. Excessive share withdrawals.	$1.00 per item
h. Certified checks	$5.00 per check
i. Stop Payment Order ..	$5.00 per order
j. Check Printing Fee	$12.00 per 200 checks (varies depending on style of check ordered)

7. *Transaction limitations.* During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to closure by the credit union or to a fee of $1.00 per item.

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* [This section should reflect any requirements concerning share accounts in the FISCU's bylaws or charter.]

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $50. The dividend period of the Credit Union is monthly, beginning on the first of a month and ending on the last day of the month.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix.]

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7 and on the share draft account disclosures in section B–7 of this appendix. The disclosures are for a variable-rate, tiered-rate (method A, option 1), average daily balance method dividend calculation, money market share account in a FISCU with a $500 minimum balance to open the account and to avoid service fees. For purposes of this example, the account was opened on January 29, 1995. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. Note that the contents of Item 9, Bylaw requirements, must be tailored to the specific bylaws of a FISCU or NICU. Also note the high par value amount in Item 10.

B–9 SAMPLE FORM (TERM SHARE [CERTIFICATE] ACCOUNT DISCLOSURES)

TERM SHARE (CERTIFICATE) ACCOUNT DISCLOSURES

1. *Rate information.* [Repeat rates disclosed on face of term share certificate, see B–5, Sample Form (Term Share (Certificate) Account).]

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited annually. If you close your certificate account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance required to open this account is $500.

4. *Balance computation method.* Dividends are calculated by the daily balance method, which applies a daily periodic rate to the principal in your account each day.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies ..... $5.00 per statement
b. Account inquiries ..... $3.00 per inquiry
c. Share transfer ..... $1.00 per transfer

7. *Transaction limitations.* After the account is opened, you may not make deposits into the account until the maturity date stated on the certificate.

8. *Maturity date.* Your account will mature on January 1, 1996.

9. *Early withdrawal penalties.* We may impose a penalty if you withdraw any of the funds before the maturity date. The penalty will equal three months' dividends on your deposit.

10. *Renewal policies.* Your certificate account will automatically renew at maturity. You will have a grace period of 10 business days after the maturity date to withdraw the funds in the account without being charged an early withdrawal penalty.

11. *Bonus.* You will receive a new (insert brand name) toaster-oven as a bonus when you open the account after December 31, 1994, and before June 30, 1995. You must maintain your entire principal on deposit until the maturity date of your certificate account to obtain the bonus.

12. **[RESERVED]**

13. *Bylaw Requirements.* [This section should reflect any requirements concerning share accounts in the FISCU's bylaws or charter.]

14. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $25. The dividend period of the Credit Union on this type of account is annual, beginning on the date the account is opened, and ending on the stated maturity date, unless renewed.

15. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

16. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix.]

Note: Even though this disclosure is for an account at a FISCU, this form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7 and upon the regular share account disclosures in section B–6 of this appendix. The disclosures are for a fixed-rate, daily balance method dividend calculation, automatically renewing term share certificate account in a FISCU with a $500 minimum balance to open the account and a ten day grace period. For the example, the account is opened on January 1, 1995 and matures on January 1, 1996. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures reflect the contracted, prospective dividend rate for a given dividend period. Note the special disclosures for term share certificate accounts, items nos. 8–10. Note also the bonus disclosure, item no. 11.

B–10 SAMPLE FORM (PERIODIC STATEMENT)

PERIODIC STATEMENT

_____ _____
Member Name Account Number

[Transaction account activity by date]

[Average daily balance of $1,500 for the month, daily compounding]

Your account earned $6.72, with an annual percentage yield earned of 5.40%, for the statement period from May 1 through and including May 31. In addition, your account earned $15 in extraordinary dividends for this period. Any fees assessed against your account are shown in the body of the periodic statement and are identified by the code at the bottom margin of this statement.

Service charge codes

SC-1 Stop Payment Order Fee
SC-2 Statement Copy Fee
SC-3 Draft Return Fee
SC-4 Transfer from Shares
SC-5 Microfilm Copy
SC-6 Share Draft Printing Fee
SC-7 Dormant Account Fee
SC-8 Wire Transfer Fee
SC-9 Excessive Share Withdrawal Fee
SC-10 _____

Other transactions

D=Dividends
EC=Error Correction
OR=Overdraft Returned
OL=Overdraft Loan
OS=Overdraft Share Transfer

Note: This form is modeled on the share draft statement of account, Form FCU 107G-SD, in the Accounting Manual for FCUs, § 5150.4. All information is self-explanatory. Codes of transactions are not required, but are a common credit union practice. The information regarding fees could also be included on the line of the periodic statement showing when the fees were debited from the account. Alternatively, a credit union could show all fees debited against the account for the statement period in a special area of the periodic statement. Clarity to the member of the required information—annual percentage yield earned; amount of dividends; fees imposed and length of period—is the important goal. An additional disclosure regarding the dollar value of any extraordinary dividends earned must be added to those statements showing the payment of such extraordinary dividends to the member.

B–11 SAMPLE FORM (RATE AND FEE SCHEDULE)

RATE AND FEE SCHEDULE

This Rate and Fee Schedule for all Accounts sets forth certain conditions, rates, fees and charges applicable to your regular share, share draft, and money market accounts at the _____ Federal Credit Union as of _____ [insert date of delivery to member]. This schedule is incorporated as part of your account agreement with the _____ Federal Credit Union.

REGULAR SHARE

Dividend Rate as of Last Dividend Declaration Date _____%

Annual Percentage Yield as of Last Dividend Declaration Date _____%

Prospective Dividend Rate _____%

Prospective Annual Percentage Yield _____%

Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Dividends Credited—At close of a dividend period

Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Minimum Opening Deposit $5.00 par value share

Minimum Monthly Balance [None, $ amount]

SHARE DRAFT

Dividend Rate as of Last Dividend Declaration Date _____%

Annual Percentage Yield as of Last Dividend Declaration Date _____%

Prospective Dividend Rate _____%

Prospective Annual Percentage Yield _____%

Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Dividends Credited—At close of a dividend period

Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Minimum Opening Deposit [None, $ amount]

Minimum Monthly Balance [None, $ amount]

MONEY MARKET

Dividend Rate as of Last Dividend Declaration Date _____%

Annual Percentage Yield as of Last Dividend Declaration Date _____%

Prospective Dividend Rate _____%

Prospective Annual Percentage Yield _____%

Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Dividends Credited— At close of a dividend period

Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]

Minimum Opening Deposit [None, $ amount]

Minimum Monthly Balance [None, $ amount]

The following fees may be assessed in connection with your accounts:

Fees Applicable to All Accounts:	
Returned item fee	$____.00 per item
Account reconciliation fee.	$____.00 per hour
Statement copies fee	$____.00 per statement
Certified draft fee	$____.00 per draft
Wire	$____.00 per transfer
Account inquiry fee	$____.00 per inquiry
Dormant account fee	$____.00 per month
Minimum balance service fee.	$____.00 per day
Share transfer fee	$____.00 per Transfer
Excessive share withdrawal transfer fee.	$____.00 per item
Share Draft Account Fees:	
Monthly service fee	$____.00 per month
Overdraft transfers fee	$____.00 per overdraft
Drafts returned insufficient funds fee.	$____.00 per draft
Stop payment order fee	$____.00 per order
Draft copy fee	$____.00 per copy
Check printing fee	$____.00 per 200 drafts
Money Market Share Account Fees:	
Monthly service fee	$____.00 per month
Check printing fee	$____.00 per 200 drafts

Note: This illustration is for use of an FCU. The information provided on a Rate and Fee Schedule can be presented in any format. To ensure that it is a part of the account agreement, if used, it should be incorporated by reference into the appropriate share account disclosures. The figures used are illustrative only, except for the overdraft transfer fee of $1.00 per overdraft and the excessive share transfer fee of $1.00 per item, which are set in the NCUA Standard FCU Bylaws, Art. III, § 4 and § 5(f), respectively.

Appendix C—Official Staff Interpretations

Introduction

1. *Official status.* This commentary is the means by which the staff of the Office of General Counsel of the National Credit Union Administration issues official staff interpretations of Part 707 of the NCUA Rules and Regulations. Good faith compliance with this commentary affords protection from liability under section 271(f) of the Truth in Savings Act (TISA), 12 U.S.C. § 4311.

§ 707.1—Authority, purpose, coverage, and effect on state laws.

(c) Coverage

1. *Foreign applicability.* Part 707 applies to all credit unions that offer share and deposit accounts to residents (including resident aliens) of any state as defined in 707.2(v) and that offer accounts insurable by the National Credit Union Share Insurance Fund (NCUSIF) whether or not such accounts are insured by the NCUSIF. Corporate credit unions designated as such by NCUA under 12 CFR § 704.2 (definition of "corporate credit union") are exempt from part 707.

2. *Persons who advertise accounts.* Persons who advertise accounts are subject to the advertising rules. This includes agent and agented accounts, such as a member who subdivides interests in a jumbo term share certificate account for sale to other parties or among members who form a certificate account investment club. For example, if an agent places an advertisement that offers members an interest inan account at a credit union, the advertising rules apply to the advertisement, whether the account is held by the agent or directly by the member.

3. *Nonautomated credit unions.* Nonautomated credit unions with an asset size of $2 million or less, after subtracting any nonmember deposits, are exempt from TISA and part 707. NCUA defines a "nonautomated credit union" as a credit union without sufficient data processing capability and capacity to establish, operate and maintain a share and loan software system to timely and accurately process all account transactions of all members. The nonautomated credit union exemption is available to all credit unions meeting the asset size and automation standards of this comment, including newly chartered credit unions. If any of the credit unions eligible for this exemption grow to have more than $2 million in assets as of December 31 of any year, the NCUA Board will require such credit unions to comply with TISA and part 707 on January 1 of one year after such credit union loses its exemption eligibility. Similarly, if a credit union becomes sufficiently automated to operate a complete share and loan system, such credit union will be entitled to the same compliance phase-in period.

(d) Effect on state laws

1. *Preemption of state laws/Inconsistent requirements.* State law requirements that are inconsistent with the requirements of TISA and part 707 are preempted to the extent of the inconsistency. A state law is inconsistent if it requires a credit union to make disclosures or take actions that contradict the requirements of the federal law. A state law is also contradictory if it requires the use of the same term to represent a different amount or a different meaning than the federal law, requires the use of a term different from that required in the federal law to describe the same item, or permits a method of calculating dividends or interest on an account different from that required in the federal law.

2. *Preemption determinations.* A credit union, state, or other interested party may request the Board to determine whether a state law requirement is inconsistent with the federal requirements. A request for a determination should be addressed to NCUA's Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314. Written preemption requests should cite (or include a copy of) the allegedly inconsistent state law, demonstrate the inconsistency with TISA and part 707 and the burden on credit unions, and formally request a preemption determination. The Office of General Counsel may provide other interested parties, particularly affected states, an informal opportunity to comment on any request for a preemption determination, unless it finds that such notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest. NCUA will publicize any preemption determinations using any means readily at its disposal.

3. *Effect of preemption determinations.* After the Board, through its Office of General Counsel, determines that a state law is inconsistent,

a credit union may not make disclosures using the inconsistent term or take actions relying on the inconsistent law.

4. *Reversal of determination.* The Board reserves the right to reverse a determination for any reason bearing on the coverage or effect of state or federal law.

§ 707.2—Definitions.

(a) Account

1. *Covered accounts.* Examples of accounts subject to the regulation are:

i. Dividend-bearing and interest-bearing accounts.

ii. Non-dividend-bearing and non-interest-bearing accounts.

iii. Accounts opened as a condition of obtaining a credit card.

iv. Escrow accounts with a consumer purpose, such as an account established by a member to escrow rental payments, pending resolution of a dispute with the member's landlord.

v. Accounts held by a parent or custodian for a minor under a state's Uniform Gift to Minors Act (or Uniform Transfers to Minors Act).

vi. Individual retirement accounts (IRAs) and simplified employee pension (SEP) accounts.

vii. Payable-on-Death (POD) or "Totten trust" accounts.

2. *Other accounts.* Examples of accounts not subject to the regulation are:

i. Mortgage escrow accounts for collecting taxes and property insurance premiums.

ii. Accounts established to make periodic disbursements on construction loans.

iii. Trust accounts opened by a trustee pursuant to a formal written trust agreement (not merely declarations of trust on a signature card such as a "Totten trust," or an IRA or SEP account).

iv. Accounts opened by an executor in the name of a decedent's estate.

v. Accounts of individuals operating businesses as sole proprietors.

vi. Certificates of indebtedness. Some credit unions borrow funds from their members through a certificate of indebtedness that sets forth the terms and conditions of the repayment of the borrowing, such as federal credit unions do through 12 CFR § 701.38. Such an account does not represent an account in a credit union and is not covered by part 707.

vii. Unincorporated nonbusiness association accounts.

3. *Other investments.* The term "account" does not apply to these products. Examples of products not covered are:

i. Government securities.

ii. Mutual funds.

iii. Annuities.

iv. Securities or obligations of a credit union.

v. Contractual arrangements such as repurchase agreements, interest rate swaps, and bankers acceptances.

vi. Purchases of U.S. Savings Bonds through a credit union.

vii. Services offered through a group purchasing plan or a credit union service organization (CUSO).

4. *Options.* All dividend-bearing and interest-bearing accounts are either fixed-rate or variable-rate accounts.

5. *Use of synonyms.* Generally, it is not the purpose of part 707 to prohibit specific descriptive terms for accounts. For example, credit unions can use adjectives and trade names to describe accounts such as "Best Share Draft Account," or "Ultra Money Market Share Account." Synonyms for share, share draft, money market share, and term share accounts may be used to describe various types of credit union share and deposit accounts as long as the synonym is accurate and not misleading and, for account disclosures, is used in conjunction with the correct legal term. For example, the following synonyms may be used:

i. The term "checking account" may be used to describe sharedraft accounts.

ii. The term "money market account" may be used to describe money market share accounts.

iii. The term "savings account" may be used to describe regular share and share accounts.

iv. The terms "share certificate," "certificate account," or "certificate" may be used to describe share certificates and other dividend-bearing term share accounts.

v. However, under no circumstances may a credit union describe a share account as a deposit account, or vice versa. For example, the term "certificate of deposit" or "CD" may not be used to describe share certificates and other dividend-bearing term share accounts. Similarly, the terms "time account" (used in Regulation DD, 12 CFR § 230.2(u)) and "time deposit"

(used in Regulation D, 12 CFR § 204.2(c)) may not be used to describe term share accounts.

(b) *Advertisement*

1. *Covered messages.* Advertisements include commercial messages in visual, oral, or print media that invite, offer, or otherwise announce generally to members and potential members the availability of member accounts such as:

i. Telephone solicitations.

ii. Messages on automated teller machine (ATM) screens (including any printout).

iii. Messages on a computer screen in a credit union's lobby (including any printout) other than a screen viewed solely by the credit union's employee.

iv. Messages in a newspaper, magazine, or promotional flyer or on radio or television.

v. Messages promoting an account that are provided along with information about the member's existing account at a credit union and that promote another account at the credit union (such as account promotional messages on the periodic statement).

2. *Other messages.* Examples of messages that are not advertisements are:

i. Rate sheets published in newspapers, periodicals, or trade journals (unless the credit union or share and deposit broker that offers accounts at the credit union pays a fee to have the information included or otherwise controls publication).

ii. Telephone conversations initiated by a member or potential member about an account.

iii. An in-person discussion with a member about the terms for a specific account.

iv. Information provided to members about their existing accounts, such as on IRA disbursements, notices for automatically renewable term share accounts sent before renewal, or current rates recorded on a voice response machine.

(c) Annual Percentage Yield.

1. *General.* The annual percentage yield (APY) is required for disclosures for new accounts, oral responses to inquiries about rates; disclosures provided upon request; initial disclosures (if the credit union chooses to provide full disclosures instead of the abbreviated notice); notices prior to the renewal of a term share account, if known at the time the notice is sent, and in advertising. The annual percentage yield shows the total amount of dividends for a 365 day period (or a 366 day period for a leap year) on an assumed principal amount based on the dividend rate and frequency of compounding as a percentage of the assumed principal (for accounts such as share or share draft accounts) or for the total amount of dividends over the term of the account for term share accounts. The annual percentage yield assumes the principal amount remains in the account for 365 days (366 days for leap year) or for the term of the account.

2. *How Annual Percentage Yield Differs from Annual Percentage Yield Earned.* The annual percentage yield (APY) differs from the annual percentage yield earned (APYE). The annual percentage yield earned is required for periodic statements only. The annual percentage yield earned shows the total amount of dividends earned for the dividend or statement period as a percent of the actual average daily balance in the member's account. Unlike the annual percentage yield, the annual percentage yield earned is affected by additions and withdrawals during the period. The annual percentage yield and the annual percentage yield earned must be calculated according to the formulas provided in Appendix A to this rule.

(d) Average Daily Balance Method.

1. *General.* One of the two required methods (the daily balance is the other) of determining the balance upon which dividends must be accrued and paid. The average daily balance method requires the application of a periodic rate to the average daily balance in the account for the average daily balance calculation period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) Board.

1. *General.* The NCUA Board.

(f) Bonus

1. *General.* Bonuses include items of value offered as incentives to members, such as an offer to pay the final installment deposit for a holiday club account if the final installment is over $10. Bonuses do not include the payment of dividends (including extraordinary dividends), the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or other consideration aggregating $10 or less per year.

2. *Examples.* The following are examples of bonuses.

i. A credit union offers $25 to potential members for becoming a member and opening

an account. The $25 could be provided by check, cash, or direct deposit.

ii. A credit union offers $25 to a member with only a regular share account to open a share draft account. The $25 could be provided by check, cash, or direct deposit.

iii. A credit union offers a portable radio with a value of $20 to members and potential members for opening a share draft account.

iv. A credit union pays the final installment deposit for a holiday club account if over $10.

3. *Examples not comprising bonuses.* The following are examples of items that are not bonuses:

i. Discount coupons distributed by credit unions for use at restaurants or stores.

ii. A credit union offers $20 to any member if the member is responsible for encouraging a potential member to open an account. The $20 is not a bonus because the $20 is not paid to the individual opening the account. Any item, including cash, given or offered to a third party (that is not a joint member or joint owner in an account being opened) in exchange for a member or potential member opening (ora member renewing or adding to) an account is not a bonus.

iii. A credit union offers $25 to a member if the member can locate his name in the body of a newsletter.

iv. Life savings benefits. Many credit unions offer life savings benefits to beneficiaries of deceased members. Because the benefit accrues to a third party, such life savings plans offered are not bonuses.

v. A credit union offers to pay annual membership dues in a benevolent organization for a class of members.

4. *De minimis rule.* Items with a de minimis value of $10 or less are not bonuses. Credit unions may rely on the valuation standard used by the Internal Revenue Service (IRS) to determine if the value of the item is de minimis. Items required to be reported by the credit union under IRS rules are bonuses under this regulation. Examples of items of de minimis value are:

i. Disability insurance premiums on a share account valued at an amount of $10 or less per year.

ii. Coffee mugs, T-shirts or other merchandise with a market value of $10 or less per year.

5. *Aggregation.* In determining if an item valued at $10 or less is a bonus, credit unions must aggregate per account per calendar year items that may be given to members. In making this determination, credit unions aggregate per account only the market value of items that may be given for a specific promotion. To illustrate, assume a credit union offers in January to give members an item valued at $7 for each calendar quarter during the year that the average account balance in a share draft account exceeds $10,000. The bonus rules are triggered, since members are eligible under the promotion to receive up to $28 during the year. However, the bonus rules are not triggered if an item valued at $7 is offered to members opening a share draft account during the month of January, even though in November the credit union introduces a new promotion that includes, for example, an offer to existing share draft accountholders for an item valued at $8 for maintaining an average balance of $5,000 for the month.

6. *Waiver or reduction of a fee or absorption of expenses.* Bonuses do not include value received by members through the waiver or reduction of fees for credit union-related services (even if the fees waived exceed $10), such as the following:

i. Waiving a safe deposit box rental fee for one year for members who open a new account.

ii. Waiving fees for travelers checks for members, and waiving check and share draft printing fees.

iii. Nondiscriminatorily waiving all fees for a particular class of members, such as seniors or minors.

iv. Discounts on interest rates charged for loans at the credit union.

v. Rebates of loan interest already paid by a member.

vi. Discounts on application fees charged for loans at the credit union.

vii. Packaged, linked, or tied-account services.

7. *Non-dividend membership benefits.* Such benefits are not bonuses because they are sporadic in nature, often difficult to value, and providing non-dividend membership benefits is a long-standing unique credit union practice. (See commentary to § 707.2(r) for examples of such benefits.)

(g) Credit union.

1. *General.* Includes credit unions in the United States, Puerto Rico, Guam, U.S. Virgin Islands, and U.S. territories. Applies to credit unions whether or not the accounts in the credit union are federally, state, privately insured, or uninsured.

(h) Daily balance method.

1. *General.* One of the two required methods (the average daily balance is the other) of determining the balance upon which dividends must be accrued and paid. The daily balance method requires the application of a daily periodic rate to the full amount of principal in the account each day.

(i) Dividend and dividends.

1. *General.* Member savings placed in share accounts are equity investments, and the returns earned on these accounts are dividends. Federal credit unions may only offer dividend-bearing and non-dividend-bearing share accounts. State-chartered credit unions may offer both share and deposit accounts if permitted by state law. State law, including without limitation regulations and official interpretations, will determine if returns earned in accounts in state-chartered credit unions are dividends. Dividends exclude the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, and extraordinary dividends. Dividend-bearing accounts must be either fixed-rate or variable-rate accounts.

2. *Procedure.* Credit unions must follow appropriate law (state law for state-chartered credit unions and federal law for federal credit unions) in determining dividend policies and declaring dividends. Generally, dividends may be viewed as a portion of the available current and undivided earnings of the credit union which is set apart, after required transfers to reserves, by valid act of the board of directors, for distribution among the members. As a matter of legal procedure, members are usually not entitled to dividends until the following steps are completed: (1) the board of the credit union develops a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable), and the method of dividend computation for each type of share account; (2) the provision for required transfers to reserves are made; (3) sufficient and available prior and/or current earnings are available at the end of the dividend period; (4) the board formally makes a dividend declaration in accordance with the credit union's dividend policy; and (5) dividends must be paid to members by a credit to the appropriate share account, payment by check or share draft, or by a combination of the two methods.

3. *When available.* Credit unions must follow the law of their primary chartering authority to determine when dividends are available. Generally, it is the declaration of the dividend itself which creates the dividend and the member has no right to receive a dividend until it is so declared. The decision of when to declare dividends lies within the official discretion of each credit union's board of directors and cannot be abrogated by contract. An agreement to pay dividends on a share account is generally interpreted not as an obligation to pay the stipulated dividends absolutely and unconditionally, but as an undertaking to pay them out of the earnings when sufficiently accumulated from which dividends in general are properly payable. Generally, "prospective rates" are rates set in good faith in advance of the close of a dividend period, that may be altered if sufficient funds are not available, or in the event of a superseding event, such as a strike, plant closure, significant fluctuation in market rates and/or a significant change in financial structure, natural disaster or emergency that alters the assumptions under which the "prospective rates" were made. It is the intent of TISA that all disclosures be accurate when made, and credit unions are urged to make every effort to ratify disclosed "prospective rates." "Prospective rates" may also be referred to as "projected rates" or similar wording, but not as "estimated rates." (See comment 3(b)-2, prohibiting use of estimates).

4. *Sample dividend resolutions.*

(i) The following resolution may be used where the dividend rates are set after the close of a dividend period.

RESOLUTION OF BOARD OF DIRECTORS FOR THE DECLARATION OF DIVIDENDS

A. I, _____, certify that I am Secretary of_____ Credit Union Board of Directors, and that the following is a correct copy of the resolution for declaring dividends adopted by the _____ Credit Union at a meeting of the Board of Directors

duly and properly held on _____,19____. This resolution appears in the minutes of this meeting and has not been rescinded or modified.

B. RESOLVED, that

(1) The Board of Directors has developed a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable), and the method of dividend computation for each type of share account;

(2) The required transfers to reserves have been made; and

(3) Sufficient and available prior and/or current earnings are available at the end of this dividend period.

C. RESOLVED, further, that the Board of Directors now formally makes a dividend declaration in accordance with the Credit Union's dividend policy and authorizes that on _____,19____, dividends must be paid to members by a credit to the appropriate share account, payment by share draft or by a combination of the two methods.

D. I further certify that the Board of Directors of this Credit Union has, and the time of adoption of this resolution had, full power and lawful authority to adopt the foregoing resolutions and that this resolution revokes any prior resolution.

IN WITNESS WHEREOF, this is my signature and the date on which I signed this Resolution.

_____

Signature

_____

Date

[Attach list of accounts with dividend rates for each type of account.]

(ii) The following resolution may be used where the dividend rates are set before the close of a dividend period.

RESOLUTION OF BOARD OF DIRECTORS FOR THE DECLARATION OF DIVIDENDS

A. I, _____, certify that I am the Secretary of_____ Credit Union, and that the following is a correct copy of the resolution for declaring dividends adopted by the_____ Credit Union at a meeting of the Board of Directors duly and properly held on _____, 19____.This resolution appears in the minutes of that meeting and has not been rescinded or modified.

B. RESOLVED, that the Board of Directors has adopted a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable) and the method of dividend computation for each type of share account.

C. RESOLVED, that it is the policy and practice of the Board of Directors to meet periodically to establish prospective dividend rates for each type of dividend-bearing share account.

D. RESOLVED, that if the required transfers to reserves have been made and there are sufficient and available prior and/or current earnings available at the end of a dividend period, the officers of the Credit Union are authorized to pay dividends at the rate prospectively established by the Board of Directors for each account for the dividend period. The officers may pay the dividends without any further action of the Board of Directors. The act of paying the dividends shall constitute the declaration of the dividends and shall be a ratification of the prospective dividend rate.

IN WITNESS WHEREOF, this is my signature and the date on which I signed this Resolution.

_____

Signature

_____

Date

[Attach list of accounts with prospective dividend rates for each type of account.]

5. *Referencing.* Except where specifically stated otherwise, use of the term "share" in part 707, as in "share account," also refers to "deposit," as in "deposit account," where appropriate (for interest-bearing or non-interest-bearing deposit accounts at some state-chartered credit unions).

(j) Dividend declaration date.

1. *General.* The importance of the dividend declaration date is to tie the last paid dividend to a certain period of time to place members and potential members on notice that the last paid dividend is different from the next dividend to be paid. In order to achieve this purpose, a credit union may use any of the following methods:

i. "As of 3/15/95" (the date the board of directors last met and declared the last paid dividend).

ii. "As of 3/31/95" (the last day of the last dividend period upon which a dividend has been paid).

iii. "For the period 1/1/95 to 3/31/95" (the last dividend period upon which a dividend has been paid).

iv. "For the first quarter of 1995" (the last dividend period upon which a dividend has been paid).

v. "For April 1995" (the last dividend period upon which a dividend has been paid).

vi. "As of the last dividend declaration date" (the last dividend period upon which a dividend has been paid).

(k) Dividend period.

1. *General.* The dividend period is to be set by a credit union's board of directors for each account type, e.g., regular share, share draft, money market share, and term share. The most common dividend periods are weekly, monthly, quarterly, semi-annually, and annually. Dividend periods need not agree with calendar months, e.g., a monthly dividend period could begin March 15 and end April 14.

(l) Dividend rate.

1. *General.* The dividend rate does not reflect compounding. Compounding is reflected in the "annual percentage yield" definition.

2. *Referencing.* Except where specifically stated otherwise, use of the term "dividend rate" in part 707 also refers to "interest rate," where appropriate (for interest-bearing and non-interest-bearing deposit accounts at some state-chartered credit unions).

(m) Extraordinary dividends.

1. *General.* The definition encompasses all irregularly scheduled and declared dividends, and as dividends, extraordinary dividends are exempt from the "bonus" disclosure requirements. Extraordinary dividends do not have to be disclosed on account disclosures, but the dollar amount of an extraordinary dividend credited to the account during the statement period does have to be separately disclosed on the periodic statement for the dividend period during which the extraordinary dividends are earned. Extra ordinary dividends, like ordinary dividends, do not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses or non-dividend membership benefits. See comments 2(f) 1 through 7 and 2(i) 1 through 4. Extraordinary dividends may be calculated by any means determined by the board of directors of a credit union and may not be used in the annual percentage yield earned calculation.

2. *Use of synonym.* Extraordinary dividends may be described as "bonus dividends."

(n) Fixed-rate account.

1. *General.* Includes all accounts in which the credit union, by contract, agrees to give at least 30 days advance written notice of decreases in the dividend rate. Thus, credit unions can decrease rates only after providing advance written notice of rate decreases, e.g., a "change-in-terms notice."

(o) Grace period.

1. *General.* A period after maturity of an automatically renewing term share account during which the member may withdraw funds without being assessed a penalty. Use of a "grace period" is discretionary, not mandatory. This definition does not refer to the "grace period" account, which is a synonym for "federal rollback method" or "in by the 10th" accounts, which are prohibited by TISA and part 707.

(p) Interest.

1. *General.* Member savings placed in deposit accounts are debt investments, and the return earned on these accounts is interest. Federal credit unions are not authorized to offer any interest-bearing deposit accounts. State-chartered credit unions may offer both share and deposit accounts if permitted by state law. State law, including without limitation regulations and official interpretations, will determine if returns earned in accounts in state-chartered credit unions are interest. Interest excludes the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, and extraordinary dividends.

2. *Differences between Dividends and Interest.* Generally, dividends are returns on an equity investment (shares); interest is return on a debt investment (deposits). Dividends, in general, are not properly payable until declared at the close of a dividend period; interest, in general, is properly payable daily according to the deposit contract. Dividend rates are prospective until actually declared; interest rates are set according to contract in advance and are earned on that basis. Share accounts establish a member (owner)/credit union (cooperative) relationship; deposit accounts establish a depositor (creditor)/depositary (debtor) relationship.

3. *Referencing.* Except where specifically stated otherwise, use of the terms "dividend" or

"dividends" in part 707 also refers to "interest" where appropriate (for interest-bearing and non-interest-bearing deposit accounts at some state-chartered credit unions).

(q) Member

1. *Professional capacity.* Examples of accounts held by a natural person in a professional capacity for another are:

i. Attorney-client trust accounts.

ii. Trust, estate and court-ordered accounts.

iii. Landlord-tenant security accounts.

2. *Other accounts.* Examples of accounts not held in a professional capacity include accounts held by parents for a child under the Uniform Gifts to Minors Act (or Uniform Transfers to Minors Act.

3. *Retirement plans.* IRAs and SEP accounts are member accounts to the extent that funds are invested in accounts subject to the regulation. Keogh accounts, like sole proprietor accounts, are not subject to the regulation.

(r) Non-dividend membership benefits.

1. *General.* Term reflects unique credit union practices that are difficult to value, encourage community spirit, and are not granted in such quantity as to be includable as calculable dividends.

2. *Examples.* Examples include:

i. Food, refreshments, and drawings and raffles at annual meetings, member functions, and branch openings.

ii. Travel club benefits.

iii. Prizes offered at annual meetings, such as U.S. Savings Bonds, a deposit of funds into the winner's account, trips, and other gifts. Such prizes are not bonuses because they are offered as an incentive to increase attendance at the annual meeting, and not to entice members to open, maintain, or renew accounts or increase an account balance.

iv. Life savings benefits.

(s) Passbook Account

1. *Relation to Regulation E.* Passbook accounts include accounts accessed by preauthorized electronic fund transfers to the account (as defined in 12 CFR § 205.2(j)), such as an account credited by direct share and deposit of social security payments. Accounts that permit access by other electronic means are not "passbook accounts," and any statements that are sent four or more times a year must comply with the requirements of 707.6.

(t) Periodic Statement

1. *General.* Periodic statements are not required by part 707. Passbook and term share accounts are exempt from periodic statement requirements.

2. *Examples.* Periodic statements do not include:

i. Additional statements provided solely upon request.

ii. General service information such as a quarterly newsletter or other correspondence that describes available services and products.

(u) Potential Member.

1. *General.* A potential member is a natural person eligible for membership in a credit union, who has not yet taken the steps necessary to become a member. The term also includes natural person nonmembers eligible to hold accounts in a credit union pursuant to relevant federal or state law.

2. *Verification of eligibility.* It is recommended that credit unions have sound written procedures in place to identify those eligible for membership. If these procedures include verification measures, such as an application process, verification telephone call or letter to an employer or association within the field of membership, witnessing by an existing member, or similar procedure, then the credit union may first verify the membership eligibility of a potential member before providing account disclosures or other information to the potential member. This process of verifying a member's eligibility status, making a recommendation for membership, and providing account disclosures should be completed within 20 calendar days. This period also applies when potential members not on credit union premises request disclosures.

3. *Nonmembers.* Within its sole discretion, the board of directors of a credit union may provide TISA disclosures to nonmembers who are ineligible for membership or to hold an account at the credit union. If disclosures are made to such nonmembers, it is the position of the Board that no civil liability can accrue to the credit union for any errors in such disclosures. (See commentary to 707.3(d)).

(v) State

General. Territories and possessions include American Samoa, Guam, the Mariana Islands, and the Marshall Islands.

(w) Stepped-rate account

1. *General.* Stepped-rate accounts are those accounts in which two or more dividend rates

(known at the time the account is opened) will take effect in succeeding periods.

2. *Example.* An example of a stepped-rate account is a one-year term share certificate account in which a 5.00 percent dividend rate is paid for the first six months, and 5.50 percent for the second six months.

(x) Term share account

1. *Relation to Regulation D.* Regulation D permits, in limited circumstances, the withdrawal of funds without penalty during the first six days after a "time deposit" is opened. (See 12 CFR § 204.2(c)(1)(i).) But the fact that a member makes a withdrawal as permitted by Regulation D does not disqualify the account from being aterm share account for purposes of this regulation (such as withdrawals upon the death of the member, or within a "grace period" for automatically renewable term share accounts).

2. *Club accounts.* Club accounts, including Christmas club, holiday club, and vacation club accounts may be either term share or regular share accounts, depending on the terms of the account. Although club accounts typically have a maturity date, they are not term share accounts unless they also require a penalty of at least seven days' dividends for withdrawals during the first six days after the account is opened.

(y) Tiered-rate Account

1. *General.* Tiered-rate accounts are those accounts in which two or more dividend rates are paid on the account and are determined by reference to a specified balance level. Tiered-rate accounts are of two types: Tiering Method A and Tiering Method B. In Tiering Method Aaccounts, the credit union pays the applicable tiered dividends rate on the entire amount in the account. This method is also known as the "hybrid" or "plateau" tiered-rate account. In Tiering Method B accounts, the credit union does not pay the applicable tiered dividends rate on the entire amount in the account, but only on the portion of the share account balance that falls within each specified tier. This method is also known as the "pure" or "split-rate" tiered-rate account. (See Appendix A, Section I, D.)

2. *Example.* An example of a tiered-rate account is one in which a credit union pays a 5.00 percent dividend rate on balances below $1,000, and 5.50 percent on balances $1,000 and above.

3. *Term share accounts.* Term share accounts that pay different rates based solely on the amount of the initial share and deposit are not tiered-rate accounts.

4. *Minimum balance accounts.* A requirement to maintain a minimum balance to earn dividends does not make an account a tiered-rate account. If dividends are not paid on amounts below a specified balance level, then the account has a minimum balance requirement (required to be disclosed under § 707.4(b)(3)(i)), but the account does not constitute a tiered-rate account. A zero rate (0%) cannot constitute a tier. Minimum balance accounts are single rate accounts with a minimum balance requirement.

(z) Variable-rate account

1. *General.* Includes accounts in which the credit union does not contract to give at least 30 days advance written notice of decreases in the dividend rate. An account meets this definition whether the rate change is determined by reference to an index, by use of a formula, or merely at the discretion of the credit union's board of directors. An account that permits one or more rate adjustments prior to maturity at the member's option, such as a rate relock option, is a variable-rate account.

2. *Differences between fixed-rate and variable-rate accounts.* All accounts must either be fixed-rate or variable-rate accounts. Classifying an account as variable-rate affects credit unions three ways:

i. Additional account disclosures are required (§ 707.4(b)(1)(ii));

ii. Rate decreases are exempted from change-in-terms requirements (§ 707.5(a)(2)(i)); and

iii. Advertising notice required (§ 707.8(c)(1)). Fixed-rate accounts require a contract term obligating the credit union to a 30-day advance, written notice to members before decreasing the dividend rate on the account. Term changes adversely affecting the member and rate decreases cannot take effect until 30 days after such fixed-rate change-in-terms notices are mailed or delivered to members (§ 707.5(a)).

§ 707.3—General disclosure requirements.

(a) Form

1. *General.* All required disclosures (e.g., account disclosures, change-in-terms notices, term share renewal/maturity notices, statement disclosures and advertising disclosures) must be made clearly and conspicuously, in a form the member may retain. Disclosures need be made

only as applicable (e.g., disclosures for a non-dividend-bearing account would not include disclosure of annual percentage yield, dividend rate, or other disclosures pertaining to dividend calculations).

2. *Design requirements.* Disclosures must be presented in a format that allows members and potential members to readily understand the terms of their account. Credit unions are not required to use a particular type size or typeface, nor are credit unions required to state any term more conspicuously than any other term. Disclosures maybe made:

i. In any order.

ii. In combination with other disclosures or account terms.

iii. In combination with disclosures for other types of accounts, as long as it is clear to members and potential members which disclosures apply to their account.

iv. On more than one page and on the front and reverse sides.

v. By using inserts to a document or filling in blanks.

vi. On more than one document, as long as the documents are provided at the same time.

3. *Consistent terminology.* A credit union must use the same terminology to describe terms or features that are required to be disclosed. For example, if a credit union describes a monthly fee (regardless of account activity), as a "monthly service fee" in account opening disclosures, the periodic statements and change-in-terms notices must use the same terminology so that members and potential members can readily identify the fee.

(b) General

1. *Terms and conditions.* Credit unions are required to have disclosures reflect the terms of the legal obligation between the credit union and a member at the time the member opens the account. This provision does not impose any contract terms or supersede state or other laws that define how the legal obligations between a credit union and its membership are determined.

2. *Specificity of legal obligation.* Credit unions may refer to the calendar month or to roughly equivalent intervals during a calendar year as a "month." Use of estimates is prohibited in TISA disclosures.

3. *Foreign language.* Disclosures may be made in any foreign language, if desired by the board of directors of a credit union. However, disclosures must also be provided in English, upon request.

(c) Relation to Regulation E

1. *General rule.* Compliance with Regulation E (12 CFR part 205) is deemed to satisfy the disclosure requirements of this regulation, such as when:

i. A credit union changes a term that triggers a notice under Regulation E, and the timing and disclosure rules of Regulation E for sending change-in-terms notices.

ii. A member adds an ATM access feature to an account, and the credit union provides disclosures pursuant to Regulation E, including disclosure of fees before the member receives ATM access. (See 12 CFR § 205.7.)

iii. A credit union complying with the timing rules of Regulation E discloses at the same time fees for electronic services (such as balance inquiry fees imposed if the inquiry is made at an ATM) that are required to be disclosed by this regulation, but not by Regulation E.

iv. A credit union relies on Regulation E's rules regarding disclosures of limitations on the frequency and amount of electronic fund transfers, including security-related exceptions. But any limitation on the number of "intra-institutional transfers" to or from the member's other accounts at the credit union during a given time period must be disclosed, even though intra-institutional transfers are exempt from Regulation E.

(d) Multiple members

1. *General.* When an account has multiple natural person member accountholders, delivery of disclosures to any member account holder or agent authorized by the account holder satisfies the disclosure requirements of part 707.

(e) Oral response to inquiries

1. *Application of rule.* Credit unions need not provide rate information orally. Disclosures need be made only as appropriate. For example, the requirement to give a telephone number for a member to call about rates for interest-bearing accounts and dividend-bearing term share accounts, would not be necessary for members calling the credit union for information. Also, the disclosure requirements are applicable only to credit union employees and volunteers acting in the ordinary course of credit union business.

2. *Relation to advertising.* The advertising rules do not cover an oral response to a question about rates.

3. *Existing accounts.* This paragraph does not apply to oral responses about rate information for existing term share accounts or accounts not currently offered. For example, if a member holding a one-year term share account requests dividend rate information about the account during the term, the credit union need not disclose the annual percentage yield, unless the member is calling for rate information under a maturity notice.

(f) Rounding and accuracy rules for rates and yields

(f)(1) Rounding

1. *Permissible rounding.* The annual percentage yield, annual percentage yield earned and dividend rate must be rounded to the nearest one-hundredth of one percentage point (.01%) when disclosed. Examples of permissible rounding are an annual percentage yield calculated to be 5.644%, rounded down and shown as 5.64%; 5.645% would be rounded up and disclosed as 5.65%. For account disclosures, the dividend rate may be expressed to more than two decimal places.

(f)(2) Accuracy

1. *Annual percentage yield and annual percentage yield earned.* The tolerance for annual percentage yield and annual percentage yield earned calculations is designed to accommodate in advertent errors. Credit unions may not purposely incorporate the one- twentieth of one percentage point (.05%) tolerance into their calculation of yields.

2. *Dividend rate.* There is no tolerance for an inaccuracy in the dividend rate.

§ 707.4—Account disclosures.

(a) Delivery of account disclosures

(a)(1) Account opening

1. *New accounts.* New account disclosures must be provided when:

i. A term share account that does not automatically rollover is renewed by a member.

ii. A member changes the term for a renewable term share account (from a one-year term share account to a six-month term share account, for instance) (see comment 5(b)-5 regarding disclosure alternatives).

iii. A credit union transfers funds from an account to open a new account not at the member's request, unless the credit union previously gave account disclosures and any change-in-terms notices for the new account (e.g., funds in a money market share account are transferred by a credit union to open a new account for the member, such as a share draft account, because the member exceeded transaction limitations on the money market share account).

iv. A credit union accepts a deposit from a member to an account that the credit union had previously deemed to be "closed," under applicable federal or state law, for the purpose of treating accrued, but uncredited, dividends as forfeited dividends. New account numbers are not required by this requirement.

2. *Acquired accounts.* New account disclosures need not be given when a credit union acquires an account through an acquisition of, or merger with, another credit union (but see 707.5(a) regarding advance notice requirements if terms are changed).

3.*Combination disclosures.* New account disclosures need not be given when a member has already received disclosures covering several accounts, and opens a new account properly disclosed by the already received combination disclosures, if the new account is opened within a reasonable amount of time after receipt of the combination disclosures and if the received disclosures and terms are accurate at the time the new account is opened.

(a)(2) Requests

(a)(2)(i)

1. *Inquiries versus requests.* A response to an oral inquiry (by telephone or in person) about rates and yields or fees does not trigger the duty to provide account disclosures. But, when a member asks for written information about an account (whether by telephone, in person, or by other means), the credit union must provide disclosures unless the account is no longer offered to the public.

2. *General requests.* When members or potential members request disclosures about a type of account (a share draft account, for example), a credit union that offers several variations may provide disclosures for any one of them. No disclosures need be made to nonmembers, though a credit union may provide disclosures to nonmembers within its sole discretion.

3. *Timing for response.* Ten business days is a reasonable time for responding to requests for account information that members do not make in person, including requests made by electronic communication.

4. *Requests by electronic communication.* Posting disclosures on a credit union's website generally does not relieve the credit union's duty to provide disclosures upon request. If the member provides an e-mail address, the credit

union may provide the disclosures electronically, but the credit union must either send the disclosures by e-mail or send a notice to the member's e-mail address pursuant to § 707.10(d)(2)(i) to inform the member where the disclosures are posted.

(a)(2)(ii)(A)(2)

1. *Recent rates.* Credit unions comply with this paragraph if they disclose an interest rate (or dividend rate on a dividend- bearing term share account) and annual percentage yield accurate within the seven calendar days preceding the date they send the disclosures.

(a)(2)(ii)(B)

1. *Term.* Describing the maturity of a term share account as "1 year" or "6 months," for example, illustrates a response stating the maturity of a term share account as a term rather than a date (e.g., "June 1, 1995").

(b) Content of account disclosures

(b)(1) Rate information

(b)(1)(i) Annual percentage yield and dividend rate

1. *Rate disclosures.* In addition to the dividend rate and annual percentage yield, credit unions may disclose a periodic rate corresponding to the dividend rate. No other rate or yield (such as "tax effective yield") is permitted. If the annual percentage yield is the same as the dividend rate, credit unions may disclose a single figure but must use both terms.

2. *Fixed-rate accounts.* For fixed-rate term share accounts paying the opening rate until maturity, credit unions may disclose the period of time the dividend rate will be in effect by stating, or cross-referencing, the maturity date. For other fixed-rate accounts, credit unions may use a date (such as "This rate will be in effect through June 30, 1995") or a period (such as "This rate will be in effect for at least 30 days").

3. *Tiered-rate accounts.* Each dividend rate, along with the corresponding annual percentage yield for each specified balance level (or range of annual percentage yields, if appropriate), must be disclosed for tiered-rate accounts. (See Appendix A, Part I, Paragraph D.)

4. *Stepped-rate accounts.* A single composite annual percentage yield must be disclosed for stepped-rate accounts. (See Appendix A, Part I, Paragraph B.) The dividend rates and the period of time each will be in effect also must be provided. When the initial rate offered for a specified time on a variable-rate account is higher or lower than the rate that would otherwise be paid on the account, the calculation of the annual percentage yield must be made as if for a stepped-rate account. (See Appendix A, Part I, Paragraph C.)

5. *Minimum balance accounts.* If a credit union sets a minimum balance to earn dividends, the credit union may, but need not, state that the annual percentage yield is 0% for those days the balance in the account drops below the minimum balance level when using the daily balance method. Nor is a disclosure of 0% required for credit unions using the average daily balance method, if the member fails to meet the minimum balance required for the average daily balance period.

(b)(1)(ii) Variable rates

(b)(1)(ii)(B)

1. *Determining dividend rates.* To disclose how the dividend rate is determined, credit unions must:

i. Identify the index and specific margin, if the dividend rate is tied to an index.

ii. State that rate changes are within the credit union's discretion, if the credit union does not tie changes to an index.

(b)(1)(ii)(C).

1. *Frequency of rate changes.* A credit union reserving the right to change rates at its discretion must state the fact that rates may change at any time.

(b)(1)(ii)(D)

1. *Limitations.* A floor or ceiling on rates or on the amount the rate may decrease or increase during any time period must be disclosed. Credit unions need not disclose the absence of limitations on rate changes.

(b)(2) Compounding and crediting

(b)(2)(i) Frequency

1. *General.* Descriptions such as "quarterly" or "monthly" are sufficient. Irregular crediting and compounding periods, such as if a cycle is cut short at year end for tax reporting purposes, need not be disclosed.

2. *Dividend period.* For dividend-bearing accounts, the dividend period must be disclosed. (A specific example must also begiven, see Appendix B, B-1(c).) The dividend period for term share accounts generally may be disclosed as the account's term (e.g., two years).

(b)(2)(ii) Effect of closing an account

1. *Deeming an account closed.* A credit union may, subject to state or other law, provide in account contracts the actions by members that will be treated as closing the account and that will result in the forfeiture of accrued but uncredited dividends. An example is the with-

drawal of all funds from the account prior to the date dividends are credited. Credit unions are cautioned that bylaw requirements may prevent a credit union from deeming a member's account closed until certain time periods are extinguished if funds remain in a member's account. *NCUA Standard FCU Bylaws,* Art. III, section 3 (members have at least six months to replenish membership share before membership terminates and account is deemed closed). Such bylaw requirements may not be overridden without proper agency approval.

(b)(3) Balance information

(b)(3)(i) Minimum balance requirements

1. *Par value.* Credit unions must disclose any minimum balance required to open the account, to avoid the imposition of a fee, or to obtain the annual percentage yield. Since members cannot generally maintain any accounts until the par value of the membership share is paid in full, this section requires that credit unions disclose the par value of a share necessary to become a member and maintain accounts at the credit union. The par value of a share and the minimum balance requirement do not have to be the same amount (e.g., a credit union may have a $5 par value for a membership share, in order for accounts to be opened and maintained, and a $100 minimum balance requirement, in order for the account to earn dividends).

2. *Disclosures.* The explanation of minimum balance computation methods may be combined with the balance computation method disclosures (§ 707.4(b)(3)(ii)) if they are the same. If a credit union uses different cycles for determining minimum balance requirements for purposes of assessing fees and for paying dividends, the credit union must disclose the specific cycle or time period used for each purpose (e.g., use of a midmonth statement cycle for determining dividends, and use of a calendar month cycle for determining fees). Credit unions may assess fees by using any method. If fees on one account are tied to the balance in another account, such provision must be explained (e.g., if share draft fees are tied to a minimum balance in the regular share account (or a combination of the share draft and regular share accounts), the share draft account must explain that fact and how the balance in the regular share account (or both accounts) is determined). The fee need not be disclosed in the account disclosures if the fee is not imposed on that account.

(b)(3)(ii) Balance computation method

1. *Methods and periods.* Credit unions may use different methods or periods to calculate minimum balances for purposes of imposing a fee (the daily balance for a calendar month, for example) and accruing dividends (the average daily balance for a statement period, for example). Each method and corresponding period must be disclosed.

(b)(3)(iii) When dividends begin to accrue

1. *Additional information.* Credit unions must include a statement as to when dividends begin to accrue for non cash deposits. Credit unions may disclose additional information such as the time of day after which deposits are treated as having been received the following business day, and may use additional descriptive terms such as "ledger" or "collected" balances to disclose when dividends begin to accrue. Under the ledger balance method, dividends begin to accrue on the day of deposit. Under the collected balance method, dividends begin to accrue when provisional credit is received for the item deposited.

(b)(4) Fees

1. *Types of fees.* Fees related to the routine use of an account must be disclosed. The following are types of fees that must be disclosed in connection with an account:

i. Maintenance fees, such as monthly service fees.

ii. Fees related to share deposits or withdrawals.

iii. Fees for special services, such as stop payment fees, fees for balance inquiries or verification of shares and deposits, fees associated with checks returned unpaid, fees for regularly sending to members share drafts that otherwise would be held by the credit union, and overdraft line of credit access fees (if charged against the share account).

iv. Fees to open or to close an account.

v. Fees imposed upon dormant or inactive accounts.

2. *Other fees.* Credit unions need not disclose fees such as the following:

i. Fees for services offered to members and nonmembers alike, such as fees for certain travelers checks, for wire transfers and automated clearinghouse (ACH) transfers, to process credit card cash advances, or to handle U.S. Savings Bond redemption (even if different amounts are charged to members and nonmembers).

ii. Incidental fees, such as fees associated with state escheat laws, garnishment or attor-

neys fees, to change names on an account, to generate a midcycle periodic statement, to wrap loose coins, for photocopying for statements returned to the credit union because of a wrong address, and locator fees.

3. *Amount of fees.* Credit unions are cautioned that merely providing fee information in an account disclosure may not be sufficient to gain the legal right to impose the fee involved under applicable law. Credit unions must state the amount and conditions under which a fee may be imposed. Naming and describing the fee typically satisfies this requirement. Some examples are:

i. "$4.00 monthly service fee".

ii. "$7.00 and up" or "fee depends on style of checks ordered" for check printing fees.

4. *Tied-accounts.* Credit unions must state if fees that maybe assessed against an account are tied to other accounts at the credit union. For example, if a credit union ties the fees payable on a share draft account to balances held in the share draft account and in a regular share account, the share draft account disclosures must state that fact and explain how the fee is determined.

5. *Regulation E statements.* Some fees are required to be disclosed under both Regulation E (12 CFR § 205.7) and part 707. If such fees, such as ATM transaction fees, are disclosed on a Regulation E statement, they need not be disclosed again on a periodic statement required under part 707.

(b)(5) Transaction limitations

1. *General rule.* Examples of limitations on the number or dollar amount of share deposits or withdrawals that credit unions must disclose are:

i. Limits on the number of share drafts or checks that may be written on an account for a given time period.

ii. Limits on withdrawals or share deposits during the term of a term share account.

iii. Limitations required by Regulation D, such as the number of withdrawals permitted from money market share accounts by check to third parties each month (credit unions need not disclose reservation of right to require a notice for withdrawals from accounts required by federal or state law).

(b)(6) Features of term share accounts

(b)(6)(i) Time requirements

1. *"Callable"* term share accounts. In addition to the maturity date, credit unions must state the date or the circumstances under which the credit union may redeem a term share account at the credit union's option (a "callable" term share account).

(b)(6)(ii) Early withdrawal penalties

1. *General.* The term "penalty" may, but need not, be used to describe the loss that may be incurred by members for early withdrawal of funds from term share accounts.

2. *Examples.* Examples of early withdrawal penalties are:

i. Monetary penalties, such as a specific dollar amount (e.g., "$10.00") or a specific days' worth of dividends (e.g., "seven days' dividends plus accrued but uncredited dividends, but only if the account is closed").

ii. Adverse changes to terms such as the lowering of the dividend rate, annual percentage yield, or reducing the compounding or crediting frequency for funds remaining in shares or on deposit.

iii. Reclamation of bonuses

3. *Relation to rules for IRAs or similar plans.* Penalties imposed by the Internal Revenue Code for certain withdrawals from IRAs or similar pension or savings plans are not early withdrawal penalties for purposes of this regulation.

4. *Disclosing penalties.* Penalties may be stated in months, whether credit unions assess the penalty using the actual number of days during the period or using another method such as a number of days that occurs in any actual sequence of the total calendar months involved. For example, stating "one month's dividends" is permissible, whether the credit union assesses 30 days' dividends during the month of April, or selects a time period between 28 and 31 days for calculating the dividends for all early withdrawals regardless of when the penalty is assessed.

(b)(6)(iv) Renewal policies

1. *Rollover term share accounts.* Credit unions are not required to provide a grace period, to pay dividends during the grace period, or to disclose whether or not dividends will be paid during the grace period. Credit unions offering a grace period on term share accounts must give the length of the grace period. Commentary, Appendix B, Model Clauses, B-1(i)(iv).

2. *Non rollover term share accounts.* Credit unions that pay dividends on funds following the maturity of term share accounts that do not renew automatically need not state the rate (or annual percentage yield) that may be paid.

(b)(7) Bonuses

1. *General.* Credit unions are required to state the amount and type of bonus, and disclose any minimum balance or time requirement to obtain the bonus and when the bonus will be provided. If the minimum balance or time requirement is otherwise required to be disclosed, credit unions need not duplicate the disclosure for purposes of this paragraph.

(b)(8) Nature of dividends

1. *General.* Dividends are not payable until declared and unless sufficient current and undivided earnings are available after required transfers to reserves at the close of a dividend period. A disclosure explaining dividends educates members and protects credit unions in the event that a prospective dividend cannot be paid, or is not properly payable. This disclosure is required for all dividend-bearing share accounts. Term share accounts need not include a statement regarding the nature of dividends.

2. *State-chartered credit unions with interest-bearing deposit accounts.* State law controls the nature of accounts (i.e., whether an account is a share account or a deposit account). If a member of a state-chartered credit union is opening only an interest-bearing deposit account, or is requesting account disclosures only for an interest-bearing deposit account (if state law requires the deposit or to hold a share account), the disclosures must generally include the following information on any dividend-bearing share portion of the account (e.g., membership share): the par value of a share; a statement that the portion of the deposit that represents the par value of the membership share will earn dividends; and that dividends are paid from current income and available earnings after required transfers to reserves. Further additional disclosures, such as a separate dividend rate and annual percentage yield for the membership share, are not required (if the additional disclosures would agree with the remainder of the account which is invested in an interest-bearing deposit).

(c) Notice to existing accountholders

1. *General.* Only members who receive periodic statements (provided regularly at least four times per year) and who hold accounts of the type offered by the credit union as of the compliance date of part 707 (generally January 1, 1995) must receive the notice. If following receipt of the notice members request disclosures, credit unions have twenty calendar days from receipt of the request to provide the disclosures. Rate and annual percentage yield information in such disclosures must conform to that required for disclosures upon request. As an alternative to including the notice in or on the periodic statement, the final rule permits credit unions to send the account disclosures themselves, as long as they are sent at the same time as the periodic statement (the disclosures may be mailed either with the periodic statement or separately).

2. *Form of the notice.* The notice may be included on the periodic statement, in a member newsletter, or on a statement stuffer or other insert, if it is clear and conspicuous. The notice cannot be sent in a separate mailing from the periodic statement.

3. *Timing.* The notice may accompany the first periodic statement after the compliance date for part 707, or the periodic statement for the first cycle beginning after that date. For example, a credit union's statement cycle is December 15, 1994—January 14, 1995. The statement is mailed on January 15. The next cycle is January 15, 1995 through February 14, 1995, and the statement for that cycle is mailed on February 15. The credit union may provide the notice either on or with the January 15 statement or on or with the February 15 statement, as it covers the first cycle after January 1, 1995.

4. *Early compliance.* Credit unions that provide the notice to existing members prior to the compliance date of part 707, must be prepared to provide accurate and timely disclosures when, following receipt of the notice, members ask for account disclosures. Such disclosures must be provided even if they are requested before the compliance date of part 707. Credit unions who provide early notice to existing members need to comply with other aspects of part 707, but need not provide disclosures already provided in compliance with part 707.

§ 707.5—Subsequent disclosures.

(a) Change in terms

(a)(1) Advance notice required

1. *Form of notice.* Credit unions may provide a change-in-term notice on or with a regular periodic statement or in another mailing (such as a highlighted portion of a newsletter or statement stuffer insert). If a credit union provides notice through revised account disclosures, the changed term must be highlighted in some manner. For example, credit unions may state that a particular fee has been changed (also

specifying the new amount) or use an accompanying letter that refers to the changed term. Credit unions are cautioned that unless credit unions have reserved the right to change terms in the account agreement or disclosures, a change-in-terms notice may not be sufficient to amend the terms under applicable law.

2. *Effective date.* An example of language for disclosing the effective date of a change is: "As of May 11, 1995."

3. *Terms that change upon the occurrence of an event.* A credit union offering terms that will automatically change upon the occurrence of a stated event need not send an advance notice of the change provided the credit union fully describes the conditions of the change in the account opening disclosures (and sends any change-in-term notices regardless of whether the changed term affects that member's account at that time).

4. *Examples.* Examples of changes not requiring an advance change-in-terms notice are:

i. The termination of employment for employee-members for whom account maintenance or activity fees were waived during their employment by the credit union.

ii. The expiration of one year in a promotion described in the account opening disclosures to "waive $4.00 monthly service charges for one year".

(a)(2) No notice required

(a)(2)(ii) Check printing fees

1. *Increase in fees.* A notice is not required for an increase in fees for printing share drafts (or deposit and withdrawal slips) even if the credit union adds some amount to the price charged by the vendor.

(b) Notice before maturity for term share accounts longer than one month that renew automatically

1. *Maturity dates on non business days.* In determining the term of a term share account, credit unions may disregard the fact that the term will be extended beyond the disclosed number of days if the maturity date falls on a nonbusiness day. For example, a holiday or weekend may cause a "one-year" term share account to extend beyond 365 days (or 366, in a leap year), or a "one-month" term share account to extend beyond 31 days.

2. *Disclosing when rates will be determined.* Ways to disclose when the annual percentage yield will be available include the use of:

i. A specific date, such as "October 28".

ii. A date that is easily discernible, such as "the Tuesday prior to the maturity date stated on the notice" or "as of the maturity date stated on this notice".

3. *Alternative timing rule.* Under the alternative timing rule, a credit union that offers a 10-day grace period would have to provide the disclosures at least 10 calendar days prior to the scheduled maturity date.

4. *Club accounts.* If members have agreed to the transfer of payments from another account to a club term share account for the next club period, the credit union must comply with the requirements for automatically renewable term share accounts—even though members may withdraw funds from the club account at the end of the current club period.

5. *Renewal of a term share account.* In the case of a change-in- terms that becomes effective if a rollover term share account is subsequently renewed:

i. If the change is initiated by the credit union, the disclosure requirements of this paragraph apply. (Paragraph 707.5(a) applies if the change becomes effective prior to the maturity of the existing term share account.)

ii. If the change is initiated by the member, the account opening disclosure requirements of § 707.4(b) apply. (If the notice required by this paragraph has been provided, credit unions may give new account disclosures or disclosures that reflect the new term.)

6. *Example.* If a member receives a notice prior to maturity on a one-year term share account and requests a rollover to a six-month account, the credit union must provide either account opening disclosures including the new maturity date or, if all other terms previously disclosed in the prematurity notice remain the same, only the new maturity date.

(b)(1) Maturities of longer than one year

1. *Highlighting changed terms.* Credit unions need not highlight terms that have changed since the last account disclosures were provided.

(c) Notice before maturity for term share accounts longer than one year that do not renew automatically

1. *Subsequent account.* When funds are transferred following maturity of a non rollover term share account, credit unions need not provide account disclosures unless a new account is established.

§ 707.6—Periodic statement disclosures.

(a) Rule When Statement and Crediting Periods Vary

1. *General.* Credit unions are not required to provide periodic statements. If they provide periodic statements, disclosures need only be furnished to the extent applicable. For example, if no dividends are earned for a statement period, credit unions need not state that fact. Or, credit unions may disclose "$0" dividends earned and "0%" annual percentage yield earned.

2. *Regulation E interim statements.* When a credit union provides regular quarterly statements, and in addition provides a monthly interim statement to comply with Regulation E, the interim statement need not comply with this section unless it states dividend or rate information. (See 12 CFR § 205.9.) For credit unions that choose not to treat Regulation E activity statements as part 707 periodic statements, the quarterly periodic statement must reflect the annual percentage yield earned and dividends earned for the full quarter. However, credit unions choosing this option need not redisclose fees already disclosed on an interim Regulation E activity statement on the quarterly periodic statement. For credit unions that choose to treat Regulation E activity statements as part 707 periodic statements, the Regulation E statement must meet all part 707 requirements.

3. *Combined statements.* Credit unions may provide certain information about an account (such as a money market share account or regular share account) on the periodic statement for another account (such as a share draft account) without triggering the disclosures required by this section, as long as:

i. The information is limited to information such as the account number, the type of account, balance information, accountholders' names, and social security or tax identification number; and.

ii. The credit union also provides members a periodic statement complying with this section for the account (the money market share account or regular share account, in the example).

4. *Other information.* Additional information that may be given on or with a periodic statement, includes:

i. Dividend rates and corresponding periodic rates to the dividend rate applied to balances during the statement period.

ii. The dollar amount of dividends earned year-to-date.

iii. Bonuses paid (or any de minim is consideration of $10 or less).

iv. Fees for other products, such as safe deposit boxes.

v. Accounts not covered by the periodic statement disclosure requirements (passbook and term share accounts) may disclose any information on the statement related to such accounts, so long as such information is accurate and not misleading.

5. *When statement and crediting periods vary.* This rule permits credit unions, on dividend-bearing share accounts, to report the annual percentage yield earned and the amount of dividends earned on a statement other than on each periodic statement when the dividend period does not agree with, varies from, or is different than, the statement period. For dividend- bearing share accounts, credit unions may disclose the required information either upon each periodic statement, or on the statement on which dividends are actually earned (credited or posted) to the member's account. In addition, for accounts using the average daily balance method of calculating dividends, when the average daily balance period and the statement periods do not agree, vary or are different, credit unions may also report annual percentage yield earned and the dollar amount of dividends earned on the periodic statement on which the dividends or interest is earned. For example, if a credit union has quarterly dividend periods, or uses a quarterly average daily balance on an account, the first two monthly statements may not state annual percentage yield earned and dividends earned figures; the third "monthly" statement will reflect the dividends earned and the annual percentage yield earned for the entire quarter. The fees imposed disclosure must be given on the periodic statement on which they are imposed.

6. *Length of the period.* Credit unions must disclose the length of both the dividend period (or average daily balance calculation period) and the statement period. For example, a statement could disclose a statement period of April 16 through May 15 and further state that "the dividends earned and the annual percentage yield earned are based on your dividend period (or average daily balance) for the period April 1 through April 30."

7. *Dividend period more frequent than statement period.* Credit unions that calculate dividends on a monthly basis, but send statements on a quarterly basis, may disclose a single divi-

dend (and annual percentage yield earned) figure. Alternatively, a credit union may disclose three dividends earned and three annual percentage yield earned figures, one for each month in the quarter, as long as the credit union states the number of days (or beginning and ending date) in each dividend period if it varies from the statement period.

8. *Additional voluntary disclosures.* For credit unions not disclosing the annual percentage yield earned and dividends earned on all periodic statements, credit unions may place a notice on statements without dividends and annual percentage yield earned figures, that the annual percentage yield earned and dollar amount of dividends earned will appear on the first statement at the close of the dividend (or average daily balance) period, or similar wording. Credit unions may also choose to include a telephone number to call for interim information, if desired by a member.

(b) Statement Disclosures

(b)(1) Annual percentage yield earned

1. *Ledger and collected balances.* Credit unions that accrue interest using the collected balance method may use either the ledger or collected balance methods to determine the balance used to determine the annual percentage yield earned. Ledger balance means the record of the balance in a member's account, as per the credit union's records. (The ledger balance may reflect additions and deposits for which the credit union has not yet received final payment). Collected balance means the record of balance in a member's account reflecting collected funds, that is, cash or checks deposited in the credit union which have been presented for payment and for which payment has actually been received. (See Regulation CC, 12 CFR § 229.14).

(b)(2) Amount of dividends or interest

1. *Definition of earned.* The term "earned" is defined to include dividends and interest either "accrued" or "paid and credited." Credit unions may use either the "ledger" or the "collected" balance for either option. (See 707.6(b)(1)1 and 707.7(c)(2) of the Appendix.)

2. *Accrued interest.* Credit unions must state the amount of interest that accrued during the statement period, even if it was not credited.

3. *Terminology.* In disclosing dividends earned for the period, credit unions must use the term "dividends" or terminology such as:

"Dividends paid," to describe dividends that have been credited;

"Dividends accrued," to indicate that dividends are not yet credited.

4. *Closed accounts.* If a member closes an account between crediting periods and forfeits accrued dividends, the credit union may not show any figures for "dividends earned" or annual percentage yield earned for the period (other than zero, at the credit union's option).

5. *Extraordinary dividends.* Extraordinary dividends are not a component of the annual percentage yield earned or the dividend rate, but are an addition to the member's account. The dollar amount of the extraordinary dividends paid, denoted as a separate, identified figure, must be disclosed on the periodic statement on which the extraordinary dividends are earned. A credit union may also disclose information regarding the calculation of the extraordinary dividends, and additional annual percentage yield earned and dividend rate figures taking into account the extraordinary dividend, so long as such information is accurate and not misleading.

(b)(3) Fees imposed

1. *General.* Periodic statements must state fees disclosed under 707.4(b) that were debited to the account during the statement period, even if assessed for an earlier period.

2. *Itemizing fees by type.* In itemizing fees imposed more than once in the period, credit unions may group fees if they are the same type. But, the description must make clear that the dollar figure represents more than a single fee, for example, "total fees for checks written this period." Examples of fees that may not be grouped together are:

i. Monthly maintenance with excess activity fees.

ii. "Transfer" fees, if different dollar amounts are imposed—such as $.50 for share deposits and $1.00 for withdrawals.

iii. Fees for electronic fund transfers with fees for other services, such as balance inquiry or maintenance fees.

3. *Identifying fees.* Statement details must enable the member to identify the specific fee. For example:

i. Credit unions may use a code to identify a particular fee if the code is explained on the periodic statement or in documents accompanying the statement.

ii. Credit unions using debit slips may disclose the date the fee was debited on the periodic statement and show the amount and type of fee on the dated debit slip.

4. *Relation to Regulation E.* Disclosure of fees in compliance with Regulation E complies with this section for fees related to electronic fund transfers (for example, totaling all electronic funds transfer fees in a single figure).

(b)(4) Length of period

1. *General.* Credit unions providing the beginning and ending dates of the period must make clear whether both dates are included in the period. For example, stating "April 1 through April 30" would clearly indicate that both April 1 and April 30 are included in the period.

2. *Opening or closing an account mid-cycle.* If an account is opened or closed during the period for which a statement is sent, credit unions must calculate the annual percentage yield earned based on account balances for each day the account was open.

§ 707.7—Payment of dividends.

(a) Permissible methods

1. *Prohibited calculation methods.* Calculation methods thatdo not comply with the requirement to pay dividends on the full amount of principal in the account each day include:

i. The "rollback" method, also known as the "grace period" or "in by the 10th" method, where credit unions pay dividends on the lowest balance in the account for the period.

ii. The "increments of par value" method, where credit unions only pay dividends on full shares in an account, e.g., a credit union with $5 par value shares pays dividends on $20 of a $24 account balance.

iii. The "ending balance" method, where credit unions pay dividends on the balance in the account at the end of the period.

iv. The "investable balance" method, where credit unions pay dividends on a percentage of the balance, excluding an amount credit unions set aside for reserve requirements.

v. The "low balance" method, where credit unions pay dividends on the lowest balance in the account for any day in that period.

2. *Use of 365-day basis.* Credit unions may apply a daily periodic rate that is greater than 1/365 of the dividend rate—such as 1/360 of the dividend rate—as long as it is applied 365 days a year.

3. *Periodic dividend payments.* A credit union can pay dividends each day on the account and still make uniform dividend payments. For example, for a one-year term share account, a credit union could make monthly dividend payments that are equal to 1/12 of the amount of dividends that will be earned for a 365-day period (or 11 uniform monthly payments—each equal to roughly 1/12 of the total amount of dividends—and one payment that accounts for the remainder of the total amount of dividends earned for the period).

4. *Leap year.* Credit unions may apply a daily rate of 1/366 or 1/365 of the dividend rate for 366 days in a leap year, if the account will earn dividends for February 29.

5. *Maturity of term share accounts.* Credit unions are not required to pay dividends after term share accounts mature. Examples include:

i. During any grace period offered by a credit union for an automatically renewable term share account, if the member decides during that period not to renew the account.

ii. Following the maturity of non rollover term share accounts.

iii. When the maturity date falls on a holiday, and the member must wait until the next business day to obtain the funds.

6. *Dormant accounts.* Credit unions must pay dividends on funds in an account, even if inactivity or the infrequency of transactions would permit the credit union to consider the account to be "inactive" or "dormant" (or similar status) as defined by state or other law or the account contract.

7. *Insufficient funds.* Credit unions are not required to pay dividends on checks or share drafts deposited to a member's account that are returned for insufficient funds. If a credit union accrues dividends on a check that it later determines is not good, it may deduct from the accrued dividends any dividends attributed to the proceeds of the returned check. If dividends have already been credited before the credit union determines the item has insufficient funds, the credit union may deduct the amount of the check and associated dividends from the account balance. The amount deducted will not be reflected in the dividend amount and annual percentage yield earned reported for the next period.

8. *Account drawn below par value of a share.* If a member draws his or her account below the par value of a share, dividends would continue to accrue on the account so long as any minimum balance requirement is met. However, under the NCUA Standard FCU Bylaws, if a member who reduces his or her share balance below the value of a par value share and does

not increase the balance within at least six months, the credit union may terminate the member's membership. State-chartered credit unions may have similar termination provisions.

(a)(2) Determination of minimum balance to earn dividends

1. *General.* Credit unions may set minimum balance requirements that must be met in order to earn dividends. However, credit unions must use the same method to determine a minimum balance required to earn dividends as they use to determine the balance upon which dividends will accrue and pay. For example, a credit union that calculates dividends on the daily balance method must use the daily balance method to determine if the minimum balance to earn dividends has been met. Similarly, a credit union that calculates dividends on the average daily balance method must use the average daily balance method to determine if the minimum to earn dividends has been met. Credit unions may have a par value of a share that is different from the minimum balance requirement to earn dividends. (See commentary to § 707.4(b)(3)(i)).

2. *Daily balance accounts.* Credit unions that require a minimum balance to earn dividends may choose not to pay dividends for days when the balance drops below the required minimum balance if they use the daily balance method to calculate dividends. For example, a credit union could set a minimum daily balance level of $200 and pay dividends only those days the $200 daily balance is maintained.

3. *Average daily balance accounts.* Credit unions that require a minimum balance to earn dividends may choose not to pay dividends for the average daily balance calculation period in which the average daily balance drops below the required minimum, if they use the average daily balance method to calculate dividends. For example, a credit union could set a minimum average daily balance level of $200 and pay dividends only if the $200 average daily balance is met for the calculation period.

4. *Beneficial method.* Credit unions may not require members to maintain both a minimum daily balance and a minimum average daily balance to earn dividends, such as by requiring the member to maintain a $500 daily balance and a prescribed average daily balance (whether higher or lower). But a credit union could offer a minimum balance to earn dividends that includes an additional method that is "unequivocally beneficial" to the member such as the following:

i. A credit union using the daily balance method to calculate dividends and requiring a $500 minimum daily balance could choose to pay dividends on the account (for those days the minimum balance is not met) as long as the member maintained an average daily balance throughout the month of $400.

ii. A credit union using the average daily balance method to calculate dividends and requiring a $400 minimum average daily balance could choose to pay dividends on the account as long as the member maintained a daily balance of $500 for at least half of the days in the period.

iii. A credit union using either the daily balance method or average daily balance method to calculate dividends that requires: (A) a $500 daily balance; or (B) a $400 average daily balance to pay dividends on the account.

5. *Paying on full balance.* Credit unions must pay dividends on the full balance in the account that meets the required minimum balance. For example, if $300 is the minimum daily balance required to earn dividends, and a member deposits $500, the credit union must pay the stated dividend rate on the full $500 and not just on $200.

6. *Negative balances prohibited.* Credit unions must treat a negative account balance as zero to determine:

i. The daily or average daily balance on which dividends will be paid.

ii. Whether any minimum balance to earn dividends is met (See commentary to Appendix A, Part II, which prohibits credit unions from using negative balances in calculating the dividends figure for the annual percentage yield earned.)

7. *Club accounts.* Credit unions offering club accounts (such as a "holiday" or "vacation" club accounts) cannot impose a minimum balance requirement for dividends based on the total number or dollar amount of payments required under the club plan. For example, if a plan calls for $10 weekly payments for 50 weeks, the credit union cannot set a $500 minimum balance and then pay only if the member makes all 50 payments.

8. *Minimum balances not affecting dividends.* Credit unions may use the daily balance, average daily balance, or other computation method to calculate minimum balance requirements not involving the payment of dividends—such as to compute minimum balances for assessing fees.

(b) Compounding and crediting policies

1. *General.* Credit unions choosing to compound dividends may compound or credit dividends annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis.

2. *Withdrawals prior to crediting date.* If members withdraw funds (without closing the account), prior to a scheduled crediting date, credit unions may delay paying the accrued dividends on the withdrawn amount until the scheduled crediting date, but may not avoid paying dividends.

3. *Closed accounts.* Subject to state or other law, a credit union may choose not to pay accrued dividends if members close an account prior to the date accrued dividends are credited, as long as the credit union has disclosed that fact. If accrued dividends are paid, accrued dividends must be paid on funds up until the account is closed or the account is deemed closed. For example, if an account is closed on a Tuesday, accrued dividends on the funds through Monday would be paid. Whether (and the conditions under which) credit unions are permitted to deem an account closed by a member is determined by state or other law, if any. Credit unions are cautioned that bylaw requirements may prevent a credit union from deeming a member's account closed until certain time periods are extinguished. (See NCUA Standard FCU Bylaws, Art. III, 3 (members have at least 6 months to replenish membership share before membership can terminate and the account is deemed closed). Such bylaw requirements may not be overridden without proper agency approval.)

(c) Date dividends begin to accrue

1. *Relation to Regulation CC.* Credit unions may rely on the Expedited Funds Availability Act (EFAA) and Regulation CC (12 CFR part 229) to determine, for example, when a deposit is considered made for purposes of dividend accrual, or when dividends need not be paid on funds because a deposited check is later returned unpaid.

2. *Ledger and collected balances.* Credit unions may calculate dividends by using a "ledger" balance or "collected" balance method, as long as the crediting requirements of the EFAA are met (12 CFR § 229.14).

3. *Withdrawal of principal.* Credit unions must accrue dividends on funds until the funds are withdrawn from the account. For example, if a check is debited to an account on a Tuesday, the credit union must accrue dividends on those funds through Monday.

§ 707.8—Advertising.

(a) Misleading or inaccurate advertisements

1. *General.* All advertisements are subject to the rule against misleading or inaccurate advertisements, even though the disclosures applicable to various media differ. The word "profit" may be used when referring to dividend-bearing share accounts, as it reflects the nature of dividends. The word "profit" may not be used when referring to interest-bearing deposit accounts.

2. *Indoor signs.* An indoor sign advertising an annual percentage yield is not misleading or inaccurate if:

i. For a tiered-rate account, it also provides the upper and lower dollar amounts of the tier corresponding to the advertised annual percentage yield.

ii. For a term share account, it also provides the term required to obtain the advertised annual percentage yield.

3. *"Free" or "no cost" accounts.* For purposes of determining whether an account can be advertised as "free" or "no cost," maintenance and activity fees include:

i. Any fee imposed if a minimum balance requirement is not met, or if the member exceeds a specified number of transactions.

ii. Transaction and service fees that members reasonably expect to be imposed on an account on a regular basis (See comments 4(b)(4)-1 and2.)

iii. A flat fee, such as a monthly service fee.

iv. Fees imposed to deposit, withdraw or transfer funds, including per-check or per-transaction charges (for example, $.25 for each withdrawal, whether by check, or in person).

4. *Other fees.* Examples of fees that are not maintenance or activity fees include:

i. Fees that are not required to be disclosed under § 707.4(b)(4).

ii. Check printing fees of any type.

iii. Fees for obtaining copies of checks, whether or not the original checks have been truncated or returned to the member periodically.

iv. Balance inquiry fees.

v. Fees assessed against a dormant account.

vi. Fees for using an ATM.

vii. Fees for electronic transfer services that are not required to obtain an account, such as preauthorized transfers or home electronic credit union services.

viii. Stop payment fees and fees for share drafts or checks returned unpaid.

5. *Similar terms.* An advertisement may not use a term such as "fees waived" if a maintenance or activity fee may be imposed because it is similar to the terms "free" or "no cost."

6. *Specific account services.* Credit unions may advertise a specific account service or feature as free as long as no fee is imposed for that service or feature. For example, credit unions offering an account that is free of deposit or withdrawal fees could advertise that fact, as long as the advertisement does not mislead members by implying that the account is free and that no other fee (a monthly service fee, for example) may be charged.

7. *Free for limited time.* If an account (or a specific account service) is free only for a limited period of time—for example, for one year following the account opening—the account (or service) may be advertised as free as long as the time period is stated.

8. *Conditions not related to share accounts.* Credit unions may advertise accounts as "free" for members that meet conditions not related to share accounts, such as the member's age. For example, credit unions may advertise a share draft account as "free for persons over 65 years old," even though a maintenance or activity fee may be assessed on accounts held by members that are 65 or younger.

9. *Electronic advertising*. If an advertisement using electronic communication displays a triggering term (such as a bonus or annual percentage yield) the advertisement must clearly refer the member to the location where the additional required information begins. For example, an advertisement that includes a bonus or annual percentage yield may be accompanied by a link that directly takes the member to the additional information.

(b) Permissible rates

1. *Tiered-rate accounts.* An advertisement for a tiered-rate account that states an annual percentage yield must also state the annual percentage yield for each tier, along with corresponding minimum balance requirements. Any dividend rates stated must appear in conjunction with the annual percentage yields for each tier.

2. *Stepped-rate accounts.* An advertisement that states a dividend rate for a stepped-rate account must state all the dividend rates and the time period that each rate is in effect.

3. *Representative examples.* An advertisement that states an annual percentage yield for a type of account (such as a term share account for a specified term) need not state the annual percentage yield applicable to every variation offered by the credit union or indicate that other maturity terms are available. In an advertisement stating that rates for an account may vary depending on the amount of the initial deposit or the term of a term share account, credit unions need not list each balance level and term offered. Instead, the advertisement may:

i. Provide a representative example of the annual percentage yields offered, clearly described as such. For example, if a credit union offers a $25 bonus on all term share accounts and the annual percentage yield will vary depending on the term selected, the credit union may provide a disclosure of the annual percentage yield as follows: "For example, our 6-month share certificate currently pays a 3.15% annual percentage yield."

ii. Indicate that various rates are available, such as by stating short-term and longer-term maturities along with the applicable annual percentage yields. "We offer share certificates with annual percentage yields that depend on the maturity you choose. For example, our one-month share certificate earns a 2.75% APY. Or, earn a 5.25% APY for a three-year share certificate."

4. *Electronic communication*. A dividend rate may be stated only if it is provided in conjunction with, but not more conspicuously than, the annual percentage yield to which it relates. In an advertisement using electronic communication, the member must be able to view both rates simultaneously. This requirement is not satisfied if the member can view the annual percentage yield only by use of a link that connects the member to information appearing at another location.

(c) When additional disclosures are required

1. *Trigger terms.* The following are examples of information stated in advertisements that are not "trigger" terms:

i. "One, three, and five year share certificates available".

ii. "Bonus rates available".

iii. "1% over our current rate," so long as the rates are not determinable from the advertisement.

(c)(2) Time annual percentage yield is offered

1. *Specified recent date.* If an advertisement discloses an annual percentage yield as of a specified date, that date must be recent in relation to the publication or broadcast frequency of the media used. For example, the printing date of a brochure printed once for an account promotion that will be in effect for six months would be considered "recent," even though rates change during the six-month period. Dividend rates published in a daily newspaper or on television must be a rate offered shortly before (or on) the date the rates are published or broadcast. Similarly, dividend rates published in a daily newspaper or on television must be a rate reflecting either the preceding dividend period, or a prospective rate, and the option chosen should be noted.

2. *Reference to date of publication.* An advertisement may refer to the annual percentage yield as being accurate as of the date of publication, if the date is on the publication itself. For instance, an advertisement in a periodical may state that a rate is "current through the date of this issue," if the periodical shows the date.

(c)(5) Effect of fees

1. *Scope.* This requirement applies only to maintenance or activity fees as described in paragraph 8(a).

(c)(6) Features of term share accounts

(c)(6)(i) Time requirements

1. *Club accounts.* If a club account has a maturity date, but the term may vary depending on when the account is opened, credit unions may use a phrase such as: "The maturity date of this club account is November 15; its term varies depending on when the account is opened."

(c)(6)(ii) Early withdrawal penalties

1. *Discretionary penalties.* Credit unions imposing early withdrawal penalties on a case-by-case basis may disclose that they "may" (rather than "will") impose a penalty if that accurately describes the account terms.

(d) Bonuses

1. *General reference to "bonus."* General statements such as "bonus checking" or "get a bonus when you open a checking account" do not trigger the bonus disclosures.

(e) Exemption for certain advertisements

(e)(1) Certain media

(e)(1)(i)

1. *ATM messages.* Messages provided on ATM or computer screens are eligible for this exemption.

2. *Internet advertisements*. The exemption for advertisements made through broadcast or electronic media does not extend to advertisements made by electronic communication, such as advertisements posted on the Internet or sent by e-mail.

(e)(1)(iii)

1. *Tiered-rate accounts.* Solicitations for tiered-rate accounts made through telephone response machines must provide all annual percentage yields and the balance requirements applicable to each tier.

(e)(2) Indoor signs

(e)(2)(i)

1. *General.* Indoor signs include advertisements displayed on computer screens, banners, preprinted posters, and chalk or peg boards. Any advertisement inside the premises that can be retained by a member (such as a brochure or a printout from a computer) is not an in door sign.

(e)(3) Newsletters

1. *General.* The partial exemption applies to all credit union news letters, whether instituted before or after the compliance date of part 707. Nor must a newsletter be of any particular circulation frequency (e.g., weekly, monthly, quarterly, biannually, annually, or irregularly) or of any certain format (e.g. magazine, bulletin, broadside, circular, mimeograph, letter, or pamphlet) in order to be eligible for the partial advertising exemption.

2. *Permissible Distribution.* In order for news letters to retain the partial advertising exemption, news letters can be sent to existing credit union members only. Any distribution reasonably calculated to reach only members is also acceptable, such as:

i. Mailing newsletters to existing members.

ii. Distributing newsletters at a function reasonably limited to members, such as an annual meeting or member picnic.

iii. Displaying or offering newsletters at a credit union lobby, branch, or office.

3. *Impermissible Distribution.* Distributing a news letter in a place open to nonmembers, such as a sponsor's lunch room, is not reasonably calculated to reach only members, and such newsletter would be subject to all applicable advertising rules.

§ 707.9—Enforcement and record retention.

(c) Record retention

1. *Evidence of required actions.* Credit unions comply with the regulation by demonstrating they have done the following:

i. Established and maintained procedures for paying dividends and providing timely disclosures as required by the regulation, and.

ii. Retained sample disclosures for each type account offered to members, such as account-opening disclosures, copies of advertisements, and change-in-term notices; and information regarding the dividend rates and annual percentage yields offered.

2. *Methods of retaining evidence.* Credit unions must be able to reconstruct the required disclosures or other actions. They need not keep disclosures or other business records in hard copy. Records evidencing compliance may be retained on microfilm, microfiche, or by other methods that reproduce records accurately (including computer files). Credit unions must retain copies of all printed advertisements and the text of all advertisements conveyed by electronic or broadcast media, and newsletters.

3. *Payment of dividends.* Credit unions must retain sufficient rate and balance information to permit the verification of dividends paid on an account, including the payment of dividends on the full principal balance.

§ 707.10—Electronic Communication

(b) General Rule

1. *Relationship to the E-Sign Act*. The E-Sign Act authorizes the use of electronic disclosures. It does not affect any requirement imposed under this part other than a provision that requires disclosures to be in paper form, and it does not affect the content or timing of disclosures. Electronic disclosures are subject to the regulation's format, timing, and retainability rules and the clear and conspicuous standard. For example, to satisfy the clear and conspicuous standard for disclosures, electronic disclosures must use visual text.

2. *Clear and conspicuous standard.* A credit union must provide electronic disclosures using a clear and conspicuous format. Also, in accordance with the E-Sign Act:

i. The credit union must disclose the requirements for accessing and retaining disclosures in that format;

ii. The member must demonstrate the ability to access the information electronically and affirmatively consent to electronic delivery; and

iii. The credit union must provide the disclosures in accordance with the specified requirements.

3. *Timing and effective delivery*.

i. *When a member opens an account on-line*. When a member opens an account on-line, the member must be required to access the disclosures required under § 707.4 before the account is opened or a service is provided, whichever is earlier. A link to the disclosures satisfies the timing rule if the member cannot bypass the disclosures before opening the account. Or the disclosures in this example must automatically appear on the screen, even if multiple screens are required to view the entire disclosure. The credit union is not required to confirm that the member has read the disclosure.

ii. *For disclosures provided periodically*. Disclosures provided by mail are timely based on when the disclosures are sent. Disclosures posted at an Internet web site, such as periodic statements or change-in-terms and other notices, are timely when the credit union has both made the disclosures available and sent a notice alerting the member that the disclosures have been posted. For example, under § 707.5, credit unions must give advance notice to affected members at least 30 calendar days in advance of certain changes. For a change in terms notice posted on the Internet, a credit union must both post the notice and notify members of its availability at least 30 days in advance of the change.

4. *Retainability of disclosures*. Credit unions satisfy the requirement that disclosures be in a form that the member may keep if electronic disclosures are delivered in a format that is capable of being retained (such as by printing or storing electronically). The format must also be consistent with the information required to be provided under Section 101(c)(1)(C)(i) of the E-Sign Act, 15 U.S.C.7001(c)(1)(C)(i)), about the hardware and software requirements for accessing and retaining electronic disclosures.

5. *Disclosures provided on credit union's equipment*. A credit union that controls the equipment providing electronic disclosures to members (for example, a computer terminal located in a credit union's lobby or at a public kiosk) must ensure that the equipment satisfies the regulation's requirements to provide timely disclosures in a clear and conspicuous format and in a form that the member may keep. For example, if disclosures are required at the time of an on-line transaction, the disclosures must

be sent to the member's e-mail address or must be posted at another location such as the credit union's Internet web site, unless the credit union provides a printer that automatically prints the disclosures.

(d) Address Or Location To Receive Electronic Communication

(d)(1)

1. *Electronic address*. A member's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by the credit union.

(d)(2)

1. *Identifying account involved*. A credit union may identify a specific account in a variety of ways and is not required to identify an account by reference to the account number. For example, where the member has only one share account, and no confusion would result, the credit union may refer to "your share account." If the member has two accounts, the credit union may, for example, differentiate accounts by using terms such as "primary account" and "secondary account" or by using a truncated account number.

2. *90-day rule*. The actual disclosures provided to a member must be available for at least 90 days, but the credit union has discretion to determine whether they should be available at the same location for the entire period.

(e) Redelivery

1. *E-mail returned as undeliverable*. If an e-mail to the member (containing an alert notice or other disclosure) is returned as undeliverable, the redelivery requirement is satisfied if, for example, the credit union sends the disclosure to a different e-mail address or postal address that the credit union has on file for the member. Sending the disclosures a second time to the same electronic address is not sufficient if the credit union has a different address for the member on file.

Appendix A to Appendix C of Part 707—Annual Percentage Yield Calculation

Part I. Annual percentage yield for account disclosures and advertising purposes.

1. *Rounding for calculations.* The following are examples of permissible rounding rules for calculating dividends and the annual percentage yield:

i. The daily rate applied to a balance carried to five or more decimals. For example: .008219178%, 3.00% for a 365 day year, would be rounded to no less than .00822%.

ii. The daily dividends or interest earned carried to five or more decimals. For example; $.08219178082, daily dividends on $1,000 at 3%for a 365 day year, would be rounded to no less than $.08219.

2. *Exponents in a leap year.* The annual percentage yield formula's exponent numerator will remain 365 in leap years. The "days in term" figure used in the denominator should be consistent with the length of term used in the dividends calculation.

3. *First tier of a tiered-rate account.* When credit unions use a rate table, the first tier of a tiered rate account is to be disclosed and advertised: "Up to but not exceeding . . .", "$.01 to. . .", or similar language.

4. *Term share accounts opened in midterm.* For club accounts that meet the definition of a term share account, the annual percentage yield is based on the maximum number of days in the term not to exceed 365 days (or 366 days in a leap year).

Part II. Annual percentage yield earned for periodic statements.

1. *Balance method.* The dividend or interest figure used in the calculation of the annual percentage yield earned may be derived from the daily balance method or the average daily balance method. Regardless of the dividend calculation method, the balance used in the annual percentage yield earned formula is the average daily balance. The average daily balance calculation is the sum of the balances for each day in the period divided by the number of days in the period. The balance for each day is based on a point in time; i.e. beginning of day balance, end of day balance, closing of day balance, etc. Each day's balance, for dividend accrual and payment purposes, must be based on the same point in time and cannot be based on the day's low balance.

2. *Negative balances prohibited.* Credit unions must treat a negative account balance as zero to determine the balance on which the annual percentage yield earned is calculated. (See commentary to § 707.7(a)(2).)

A. General formula.

1. *Accrued but uncredited dividends.* To calculate the annual percentage yield earned, accrued but uncredited dividends:

i. May not be included in the balance for statements that are issued at the same time or less frequently than the account's compounding and crediting frequency. For example, if monthly statements are sent for an account that compounds dividends daily and credits dividends monthly, the balance may not be increased each day to reflect the effect of daily compounding. Assume a credit union will pay $13.70 in dividends on $100,000 for the first day, $6.85 individends on $50,013.70 for the second day, and $3.43 in dividends on $25,020.55 for the third day. The sum of each day's balance is $175,000 (does not include accrued, but uncredited, dividends amounts $13.70, $6.85, and $3.43), thereby resulting in an average daily balance for the three days of $58,333.33.

ii. Must be included in the balance for succeeding statements if a statement is issued more frequently than compounded dividends are credited on an account. For example, if monthly statements are sent for an account that compounds dividends daily and credits dividends quarterly, the balance for the second monthly statement would include dividends that had accrued for the prior month. Assume a credit union will pay $411.78 in dividends on 30 days of $100,000, $427.28 in dividends on 31 days of $100,411.78, and $415.23 in dividends on 30 days of $100,839.06. The balance (average daily balance in the account for the period) for the second 31 days is $100,411.78.

2. *Rounding.* The dividends earned figure used to calculate the annual percentage yield earned must be rounded to two decimals to reflect the amount actually paid. For example, if the dividends earned for a statement period is $20.074 and the credit union pays the member $20.07, the credit union must use $20.07 (not $20.074) to calculate the annual percentage yield earned. For accounts that pay dividends based on the daily balance method, compound and credit dividends or interest quarterly, and send monthly statements, the credit union may, but need not, round accrued dividends to two decimals for calculating the "projected" or "anticipated" annual percentage yield earned on the first two monthly statements issued during the quarter. However, on the quarterly statement the dividends earned figure must reflect the amount actually paid.

3. *Compounding frequency using the average daily balance method.* Any compounding frequency, including daily compounding, can be used when calculating dividends using the average daily balance method. (See comment § 707.7(b), which does not require credit unions to compound or credit dividends at any particular frequency).

B. Special formula for use where periodic statement is sent more often than the period for which dividends are compounded.

1. *Statements triggered by Regulation E.* Credit unions may, but need not, use this formula to calculate the annual percentage yield earned for accounts that receive quarterly statements and that are subject to Regulation E's rule calling for monthly statements when an electronic fund transfer has occurred. They may do so even though no monthly statement was issued during a specific quarter. This formula must be used for accounts that compound and credit dividends quarterly and that receive monthly statements, triggered by Regulation E, which comply with the provisions of § 707.6.

2. *Days in compounding period.* Credit unions using the special annual percentage yield earned formula must use the actual number of days in the compounding period.

Appendix B to Appendix C of Part 707—Model Clauses and Sample Forms

1. *Modifications.* Credit unions that modify the model clauses will be deemed in compliance as long as they do not delete information required by TISA or regulation or rearrange the format so as to affect the substance or clarity of the disclosures.

2. *Format.* Credit unions may use inserts to a document (see Sample Form B–11) or fill-in blanks (see Sample Forms B–4 andB–5, which use double underlining to indicate terms that have been filled in) to show current rates, fees or other terms.3. Disclosures for opening accounts. The sample forms illustrate the

information that must be provided to a member when an account is opened, as required by § 707.4(a)(1). (See § 707.4(a)(2), which states the requirements for disclosing the annual percentage yield, the dividend rate, and the maturity of a term share account in responding to a member's request.)

4. *Compliance with Regulation E.* Credit unions may satisfy certain requirements under Part 707 with disclosures that meet the requirements of Regulation E. (See § 707.3(c).) The model clauses and sample forms do not give examples of disclosures that would be covered by both this regulation and Regulation E (such as disclosing the amount of a fee for ATM usage). Credit unions should consult appendix A to Regulation E for appropriate model clauses.

5. *Duplicate disclosures.* If a requirement such as a minimum balance applies to more than one account term (to obtain a bonus and determine the annual percentage yield, for example), credit unions need not repeat the requirement for each term, as long as it is clear which terms the requirement applies to.

6. *Guide to model clauses.* In the model clauses, italicized words indicate the type of disclosure a credit union should insert in the space provided (for example, a credit union might insert "March 25, 1995" in the blank for "(date)" disclosure). Brackets and diagonals ("/") indicate a credit union must choose the alternative that describes its practice (for example, [daily balance/average daily balance]).

7. *Sample forms.* The sample forms (B–4 through B–11) serve a purpose different from the model clauses. They illustrate various ways of adapting the model clauses to specific accounts. The clauses shown relate only to the specific transactions described.

Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

§ 708a.1 Definitions.

As used in this part:

(a) *Credit union* has the same meaning as insured credit union in section 101 of the Federal Credit Union Act.

(b) *Mutual savings bank* and *savings association* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

(c) *Federal banking agencies* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

(d) *Senior management official* means a chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the appropriate federal banking agency pursuant to section 32(f) of the Federal Deposit Insurance Act, 12 U.S.C. 1831i(f).

§ 708a.2 Authority to convert.

An insured credit union, with the approval of its members, may convert to a mutual savings bank or a savings association that is in mutual form without the prior approval of the NCUA, subject to applicable law governing mutual savings banks and savings associations and the other requirements of this part.

§ 708a.3 Board of directors and membership approval.

(a) The board of directors must approve a proposal to convert by majority vote and set a date for a vote on the proposal by the members of the credit union.

(b) The membership must approve the proposal to convert by the affirmative vote of a majority of those members who vote on such proposal.

§ 708a.4 Voting procedures.

(a) A member may vote on the proposal to convert in person at a special meeting held on the date set for the vote or by written ballot filed by the member.

(b) A credit union that proposes to convert must provide written notice of its intent to convert to each member who is eligible to vote on the conversion. The notice to members must be submitted 90 calendar days, 60 calendar days, and 30 calendar days before the date of the membership vote on the conversion and a ballot must be submitted not less than 30 calendar days before the date of the vote.

(c) The notice to members must adequately describe the purpose and subject matter of the vote to be taken at the special meeting or by submission of the written ballot. The notice must clearly inform the member that the member may vote at the special meeting or by submitting the written ballot. The notice must state the date, time, and place of the meeting.

§ 708a.5 Notice to NCUA.

(a) The credit union must provide the Regional Director for the region where the credit union is located with notice of its intent to convert during the 90 calendar day period preceding the date of the membership vote on the conversion.

(b) The credit union must give notice to the Regional Director by providing a letter describing the material features of the conversion or a copy of the filing the credit union has made with another federal or state regulatory agency in which the credit union seeks that agency's approval of the conversion. The credit union must include with the notice to the Regional Director a copy of the notice the credit union provides to members under § 708a.4, as well as, the ballot form and all written materials the credit union has distributed or intends to distribute to the members.

(c) If it chooses, the credit union may provide the Regional Director notice of its intent to convert prior to the 90 calendar day period preceding the date of the membership vote on the conversion. In this case, the Regional Director will make a preliminary determination regarding the methods and procedures applicable to the membership vote. The Regional Director will notify the credit union within 30 calendar days of receipt of the credit union's notice of intent to convert if the Re-

gional Director disapproves of the proposed methods and procedures applicable to the membership vote. The credit union's prior submission of the notice of intent does not relieve the credit union of its obligation to certify the results of the membership vote required by § 708a.6 or eliminate the right of the Regional Director to disapprove the actual methods and procedures applicable to the membership vote if the credit union fails to conduct the membership vote in a fair and legal manner.

§ 708a.6 Certification of vote on conversion proposal.

The board of directors of the converting credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken. The board of directors must also certify at this time that the notice, ballot and other written materials provided to members were identical to those submitted pursuant to § 708a.5 or provide copies of any new or revised materials and an explanation of the reasons for the changes.

§ 708a.7 NCUA oversight of methods and procedures of membership vote.

(a) The Regional Director will issue a determination that the methods and procedures applicable to the membership vote are approved or disapproved within 10 calendar days of receipt from the credit union of the certification of the result of the membership vote required under § 708a.6.

(b) If the Regional Director disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote, the Regional Director may direct that a new vote be taken.

(c) The Regional Director's review of the methods by which the membership vote was taken and the procedures applicable to the membership vote includes determining that the notice to members is accurate and not misleading, that all notices required by this section were timely, and that the membership vote was conducted in a fair and legal manner.

§ 708a.8 Other regulatory oversight of methods and procedures of membership vote.

The federal or state regulatory agency that will have jurisdiction over the financial institution after conversion must verify the membership vote and may direct that a new vote be taken, if it disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote.

§ 708a.9 Completion of conversion.

(a) Upon receipt of approvals under § 708a.7 and § 708a.8 of this part, the credit union may complete the conversion transaction.

(b) Upon notification by the board of directors of the mutual savings bank or mutual savings association that the conversion transaction has been completed, the NCUA will cancel the insurance certificate of the credit union and, if applicable, the charter of the federal credit union.

§ 708a.10 Limit on compensation of officials.

No director or senior management official of an insured credit union may receive any economic benefit in connection with the conversion of the credit union other than compensation and other benefits paid to directors or senior management officials of the converted institution in the ordinary course of business.

Part 708b

Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Status

§ 708b.0 Scope.

(a) Subpart A of this Part prescribes the procedures for merging one or more credit unions with a continuing credit union where at least one of the credit unions is federally insured.

(b) Subpart B of this Part prescribes the procedures and notice requirements for termination of Federal insurance or conversion of Federal insurance to nonfederal insurance, including termination or conversion resulting from a merger.

(c) Subpart C of this Part sets forth the forms to be used for terminating Federal insurance or converting from Federal insurance to nonfederal insurance.

(d) Nothing in this Part shall operate as a restriction or otherwise impair the authority of NCUA to approve a merger pursuant to Section 205(h) of the Act.

(e) This Part does not address procedures or requirements that may be applicable under state law for a state credit union.

§ 708b.1 Definitions.

(a) "Continuing credit union" means the credit union which will continue in operation after the merger.

(b) "Merging credit union" means the credit union which will cease to exist as an operating credit union at the time of the merger.

(c) "State credit union" means any credit union organized and operated according to the laws of any state, the several territories and possessions of the United States, or the Commonwealth of Puerto Rico. Accordingly, "state authority" means the appropriate state or territorial regulatory or supervisory authority for any such credit union.

(d) "Federally-insured" means insured by the Board through the National Credit Union Share Insurance Fund (NCUSIF).

(e) "Nonfederally-insured" means insured by a private or cooperative insurance fund or guaranty corporation organized or chartered under state law.

(f) "Uninsured" means there is no share or deposit insurance available on the credit union accounts.

(g) The terms "terminate," "termination" and "terminating," when used in reference to insurance, refer to the act of canceling Federal insurance and mean that the credit union will become uninsured.

(h) The terms "convert," "conversion" and "converting," when used in reference to insurance, refer to the act of canceling Federal insurance and simultaneously obtaining share or deposit insurance from another insurance carrier. They mean that after cancellation of Federal insurance the credit union will be nonfederally insured.

Subpart A—Mergers

§ 708b.101 Mergers generally.

(a) In any case where a merger will result in the termination of Federal insurance or conversion to nonfederal insurance, the merging credit union must comply with the provisions of Subpart B in addition to this Subpart A.

(b) No federally-insured credit union shall merge with any other credit union without the prior written approval of the Board.

(c) Where the continuing credit union is a Federal credit union, there must be compliance with the chartering policies of the Board.

(d) Where the continuing or merging credit union is a state credit union, the merger must be permitted by state law or authorized by the state authority.

§ 708b.102 Special provisions for Federal insurance.

(a) Where the continuing credit union is federally insured, an NCUSIF deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) will be assessed on the additional share accounts insured as a result of the merger of a nonfederally-insured or uninsured credit union with a federally-insured credit union.

(b) Where the continuing credit union is nonfederally insured or uninsured but desires to be federally insured as of the date of the merger, an application shall be submitted to the appropriate Regional Director when the merging credit union requests approval of the merger proposal. An NCUSIF deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) will be assessed on any additional share accounts insured as a result of the merger.

(c) Where the continuing credit union is nonfederally insured or uninsured and does not make application for insurance, but the merging credit union is federally insured, the continuing credit union is entitled to a refund of the merging credit union's NCUSIF deposit and to a refund of the unused portion of the NCUSIF share insurance premium (if any). If the continuing credit union is uninsured, the refund will be made only after expiration of the one-year period of continued insurance coverage noted in subsection (e) of this section.

(d) Where the continuing credit union is nonfederally-insured, NCUSIF insurance of the member accounts of a merging federally-insured credit union ceases as of the effective date of the merger. (Refer to Subpart B, §§ 708b.203 and 708b.204 and Subpart C, § 708b.302(b).)

(e) Where the continuing credit union is uninsured, NCUSIF insurance of the member accounts of the merging federally-insured credit union will continue for a period of one year, subject to the restrictions in Section 206(d)(1) of the Act as noted in the Notice of Termination set forth in § 708b.301(b)(3). (Refer to Subpart B, §§ 708b.201 and 708b.202, and Subpart C, § 708b.301(b).)

§ 708b.103 Preparation of merger plan.

(a) Upon the approval of a proposition for merger by the boards of directors of the credit unions, a plan for the proposed merger shall be prepared. The plan shall include:

(1) current financial reports;

(2) current delinquent loan schedules annotated to reflect collection problems;

(3) combined financial report;

(4) analyses of share values;

(5) explanation of any proposed share adjustments;

(6) explanation of any provisions for reserves, undivided earnings or dividends;

(7) provisions with respect to notification and payment of creditors;

(8) explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts;

(9) provisions for determining that all assets and liabilities of the continuing credit union will conform with the requirements of the Act (where the continuing credit union is a Federal credit union); and

(10) proposed charter amendments (where the continuing credit union is a Federal credit union). These amendments, if any, will usually pertain to the name of the credit union and the definition of its field of membership.

§ 708b.104 Submission of merger proposal to NCUA.

(a) Upon approval of the merger plan by the boards of directors of the credit unions, the following information will be submitted to the Regional Director:

(1) the merger plan, as described in this Part;

(2) resolutions of the boards of directors;

(3) proposed Merger Agreement;

(4) proposed Notice of Special Meeting of the Members (for merging Federal credit unions);

(5) copy of the form of Ballot to be sent to the members (for merging Federal credit unions);

(6) evidence that the state's supervisory authority is in agreement with the merger proposal (for states which require such agreement prior to NCUA approval); and

(7) Application and Agreement for Insurance of Member Accounts (for continuing state credit unions desiring to become federally insured).

§ 708b.105 Approval of merger proposal by NCUA.

(a) In any case where the continuing credit union is federally insured, and the merging credit union is nonfederally insured or uninsured, a determination shall be made by NCUA as to the potential risk to the National Credit Union Share Insurance Fund (NCUSIF).

(b) If NCUA finds that the merger proposal complies with the provisions of this Part and does

not present an undue risk to the NCUSIF, it may approve the proposal subject to such other specific requirements as may be prescribed to fulfill the intended purposes of the proposed merger. In the event NCUA determines that the merging credit union, if it is a Federal credit union, is in danger of insolvency, and that the proposed merger would reduce the risk or avoid a threatened loss to the National Credit Union Share Insurance Fund, NCUA may permit the merger to become effective without an affirmative vote of the membership of the merging Federal credit union, notwithstanding the provisions of Section 708b.106; *Provided* that the continuing credit union is federally insured.

(c) Any proposed charter amendments for a continuing Federal credit union will be approved contingent upon the completion of the merger.

§ 708b.106 Approval of the merger proposal by members.

(a) When the merging credit union is a Federal credit union, the members shall:

(1) Have the right to vote on the merger proposal in person at the annual meeting, if within 60 days after NCUA approval, or at a special meeting to be called within 60 days of such approval, or by mail ballot, received no later than the date and time announced for the annual meeting or the special meeting called for that purpose.

(2) Be given advance notice of the meeting at which the merger proposal is to be submitted, in accordance with the provisions of Article V, Meetings of Members, Federal Credit Union Bylaws. The notice shall:

(i) specify the purpose of the meeting and the time and place;

(ii) include a summary of the merger plan, which shall contain, but not necessarily be limited to, current financial reports for each credit union, a combined financial report for the continuing credit union, analyses of share values, explanation of any proposed share adjustments, explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts (refer to Subpart B, §§ 708b.202 and 708b.204);

(iii) state reasons for the proposed merger;

(iv) provide name and location (to include branches) of the continuing credit union;

(v) inform the members that they have the right to vote on the merger proposal in person at the meeting or by written ballot to be received no later than the date and time announced for the annual meeting or the special meeting called for that purpose; and

(vi) be accompanied by a Ballot for Merger Proposal.

(b) The proposal to merge a Federal credit union into a federally-insured credit union must be approved by an affirmative vote of a majority of the members of the merging credit union who vote on the proposal. If the continuing credit union is uninsured, the voting requirements of § 708b.201(c) apply; if it is nonfederally insured, the voting requirements of § 708b.203(c) apply.

§ 708b.107 Certificate of vote on merger proposal.

The board of directors of the merging Federal credit union shall certify the results of the membership vote to the Regional Director within 10 days after the vote is taken.

§ 708b.108 Completion of merger.

(a) Upon approval of the merger proposal by NCUA and by the state supervisory authority (where the continuing or merging credit union is a state credit union) and by the members of each credit union where required, action may be taken to complete the merger.

(b) Upon completion of the merger, the board of directors of the continuing credit union shall certify the completion of the merger to the Regional Director within 30 days after the effective date of the merger.

(c) Upon NCUA's receipt of certification that the merger has been completed, then the charter of the merging Federal credit union (if applicable) and the insurance certificate of any merging federally-insured credit union will be canceled.

Subpart B—Voluntary Termination or Conversion of Insured Status

§ 708b.201 Termination of insurance.

(a) A state credit union may terminate Federal insurance, if permitted by state law, either on its own or by merging into an uninsured credit union.

(b) A Federal credit union may terminate Federal insurance only by merging into, or converting its charter to, an uninsured state credit union.

(c) Termination of insurance must be approved by the affirmative vote of a majority of the credit union's members. The credit union must notify the Board, through the Regional Director, in writing at least 90 days prior to termination and the membership vote must have been obtained within one year prior to giving the Board notice.

(d) No federally-insured credit union shall terminate Federal insurance without the prior written approval of the Board. The Board will approve or disapprove the termination in writing within 90 days after being notified by the credit union.

§ 708b.202 Notice to members of termination of insurance.

(a) When a federally-insured credit union proposes to terminate Federal insurance, including termination due to a merger or conversion of charter, it shall provide its members with written notice of the proposal to terminate and of the date set for the membership vote. The Notice of Proposal shall be as set forth in either § 708b.301 (a)(1) or (b)(1), or as provided in § 708b.301(c), as the circumstances warrant.

(b) The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 nor less than 7 days prior to the date of the vote. The membership shall be given the opportunity to vote by mail ballot. The ballot to be used shall be as set forth in either § 708b.301 (a)(2) or (b)(2), as the circumstances warrant. The notice of the proposal and the ballot may be provided to members at the same time.

(c) If the proposition for termination of insurance is approved by the membership and the Board, prompt and reasonable notice of termination shall be given to all members in the form set forth in either § 708b.301 (a)(3) or (b)(3), as the circumstances warrant.

§ 708b.203 Conversion of insurance.

(a) A federally-insured state credit union may convert to nonfederal insurance, if permitted by state law, either on its own or by merging into a nonfederally-insured credit union.

(b) A Federal credit union may convert to nonfederal insurance only by merging into, or converting its charter to, a nonfederally-insured state credit union.

(c) Conversion of Federal to nonfederal insurance must be approved by an affirmative vote of a majority of the credit union's members who vote on the proposition, provided at least 20 percent of the total membership participates in the voting. The credit union must notify the Board, through the Regional Director, in writing at least 90 days prior to conversion. Notice to the Board may be given when membership approval is solicited or after membership approval is obtained.

(d) No federally-insured credit union shall convert to nonfederal insurance without the prior written approval of the Board. The Board will approve or disapprove the conversion in writing within 90 days after being notified by the credit union.

§ 708b.204 Notice to members of conversion of insurance.

(a) When a federally-insured credit union proposes to convert to nonfederal insurance, including conversion due to a merger or conversion of charter, it shall provide its members with written notice of the proposal to convert and of the date set for the membership vote. Notice of the proposal shall be as set forth in either § 708b.302 (a)(1) or (b)(1), or as provided in § 708b.302(c), as the circumstances warrant.

(b) The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 nor less than 7 days prior to the date for the vote. The membership shall be given the opportunity to vote by mail ballot. The ballot to be used for the membership vote shall be as set forth in either § 708b.302 (a)(2) or (b)(2), as the circumstances warrant. The notice of the proposal and the ballot may be provided to the members at the same time.

(c) If the proposition for conversion of insurance is approved by the membership and the Board, prompt and reasonable notice shall be given to all members in the form set forth in either § 708b.302 (a)(3) or (b)(3), as the circumstances warrant.

Subpart C—Forms

§ 708b.301 Termination of insurance.

(a) A federally-insured state credit union shall use the following language for purposes of terminating Federal insurance:

(1) Notice of Proposal to Terminate Federal Insurance

_____(Date)

The Board of Directors of _____ Credit Union has approved a proposition to terminate Federal share (deposit) insurance ($100,000, provided by the National Credit Union Administration (NCUA), an agency of the Federal Government). Termination of Federal insurance may only take place upon approval by a majority of our members. The membership vote will be taken on date. (Add directions regarding membership meeting and/or mail ballot.)

If approved, any deposits made by you after the date of termination, either new deposits or additions to existing accounts, will not be insured by the NCUA or any other entity. In the event the credit union fails, these deposits are not insured by the federal government. No provision has been made for alternative insurance, therefore, these deposits will be uninsured.

Accounts in the Credit Union on the day of termination, up to a maximum of $100,000 for each member, will continue to be insured, as provided in the Federal Credit Union Act, for one (1) year after the close of business on the day of termination, but any withdrawals after the close of business on that date will reduce the insurance coverage by the amount of the withdrawal.

(2) The ballot for obtaining membership approval to terminate Federal insurance shall contain the following language:

This ballot must be received by the Credit Union by _____(date for vote)_____

I understand that if termination of Federal insurance is approved, any new deposits or additions to existing accounts made by me will not be insured by the National Credit Union Administration, an agency of the Federal Government. I also understand that my accounts in the Credit Union on the date of termination, up to a maximum of $100,000, will continue to be insured for one (1) year after the date of termination, but that any withdrawals after the date of termination will reduce the insurance coverage by the amount of the withdrawal.

[ ] Approve termination of insurance.

[ ] Do not approve termination of insurance.

Signed _____

Member's Name

Date _____

(3) *Notice of Termination*

_____

1. The status of the _____as an insured credit union under the provisions of the Federal Credit Union Act will terminate as of the close of business on the _____day of_____.
2. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration.
3. Accounts in the Credit Union on the _____day of_____, up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) _____day of_____; year after the close of business on the _____day of_____; Provided, however, that any withdrawals after the close of business on the day of _____, will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)
(Address)

_____

(b) A federally-insured credit union that is merging with an uninsured credit union shall use the following language for purposes of terminating Federal insurance:

(1) *Notice of Proposal to Merge and Terminate Federal Insurance*

The Board of Directors of ___merging___ Credit Union has approved a proposi-

tion to merge the Credit Union into the (continuing) Credit Union. The merger must be approved by a majority of the members of (merging) Credit Union. The membership vote will be taken on (date). (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the merger, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, (NCUA), an agency of the Federal Government) will be affected as follows:

Any deposits made by you after the effective date of the merger, either new deposits or additions to existing accounts, will not be insured by the NCUA or any other entity. In the event the credit union fails, these deposits are not insured by the federal government. No provision has been made for alternative insurance, therefore, these deposits will be uninsured. Accounts in the *merging* Credit Union on the date of the merger, up to a maximum of $100,000 for each member, will continue to be insured, as provided in the Federal Credit Union Act, for one (1) year after the close of business on the date of the merger, but any withdrawals after the close of business on that date will reduce the insurance coverage by the amount of the withdrawal.

(2) The language for the ballot set forth in (a)(2) above, modified by substituting "the merger and termination" in lieu of "termination" each time it appears on the ballot, shall be used for obtaining membership approval to merge and terminate Federal insurance.

(3) *Notice of Merger and Termination of Federal Insurance*

1. The merger of the (merging) Credit Union into the (continuing) Credit Union has been approved, effective (date).
2. The status of the (merging) Credit Union as an insured credit union under the provisions of the Federal Credit Union Act will terminate as of the close of business on the ____day of _____ (day preceding merger date).
3. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration.
4. Accounts in the Credit Union on the ___day of _____, (day preceding merger date), up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) year after close of business on the _____day of _____, (day preceding merger date); Provided, however, that any withdrawals after the close of business on the ___day of _____, _____(day preceding merger date), will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)
(Address)

(c) A Federal credit union that is converting its charter to that of an uninsured state credit union shall use the language contained in subsection (a) of this Section, but shall modify the language in (a)(1) to indicate that it is converting its charter and terminating Federal insurance.

§ 708b.302 Conversion of insurance.

(a) A federally-insured state credit union shall use the following language for purposes of converting from Federal insurance to nonfederal insurance:

(1) *Notice of Proposal to Convert to Non-federally-Insured Status*

The Board of Directors of _____ Credit Union has approved a proposition to convert from Federal share (deposit) insurance to nonfederal insurance. The conversion must be approved by a majority of the members who vote on the proposal and at least 20% of the entire membership must participate in the vote. The membership vote will be taken on (date). (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the conversion, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, an

agency of the Federal Government) will terminate on the effective date of the conversion. Shares (deposit) in the _____ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____. The insurance provided by the National Credit Union Administration, an independent agency of the United States, is backed by the full faith and credit of the United States government. The private insurance you will receive from _____ is not guaranteed by the federal or any state government.

(2) The ballot to obtain membership approval of the conversion shall contain the following language:

This ballot must be received by the Credit Union by _____(date for vote)_____.

I understand that, if the conversion of insurance is approved, the share (deposit) insurance that I now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate upon the effective date of the conversion and my shares will be insured up to $_____ by _____, a corporation chartered by the State of _____. The private insurance provided by _____ is not backed by the full faith and credit of the United States government as is the federal insurance provided by the National Credit Union Administration.

[ ] Approve conversion of insurance.

[ ] Do not approve conversion of insurance.

Signed _____
Member's Name
Date _____

(3) *Notice of Conversion*

_____(Date)

1. The status of the _____as an insured credit union under the provisions of the Federal Credit Union Act will cease as of the close of business on the ____day of _____, _____.
2. As of that date, your deposits will no longer be insured by the National Credit Union Share Insurance Fund.
3. Accounts in the credit union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

(Name of Credit Union)
(Address)
_____

(b) A federally-insured credit union that is merging with a nonfederally-insured credit union shall use the following language for purposes of converting from Federal to nonfederal insurance:

(1) *Notice of Proposal to Merge and Convert to Nonfederally-Insured Status*

"The Board of Directors of __(merging)__ Credit Union has approved a proposition to merge the Credit Union into the __(continuing)__ Credit Union. The merger must be approved by a majority of the members of __(merging)__ Credit Union who vote on the proposal and at least 20% of the entire membership must participate in the vote. The membership vote will be taken on __(date)__. (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the merger, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate on the effective date of the merger. Shares (deposit) in the __(continuing)__ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____. The insurance provided by the National Credit Union Administration, an independent agency of the United States, is backed by the full faith and credit of the United States government. The private insurance you will receive from _____ is not guaranteed by the federal or any state government.

(2) The ballot to obtain membership approval shall contain the following language:

This ballot must be received by the Credit Union by _____(date for vote)_____.

I understand that if the merger of the __(merging)__ Credit Union into the __(continuing)__ Credit Union is approved, the share (deposit) insurance that I now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate upon the effective date of the merger and my shares in the ____(continuing)____ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of_____.
The private insurance provided by _____ is not backed by the full faith and credit of the United States government as is the federal insurance provided by the National Credit Union Administration.

[ ] Approve merger and conversion of insurance.

[ ] Do not approve merger and conversion of insurance.

Signed _____
Member's Name
Date _____

(3) *Notice of Merger and Conversion of Insured Status*

_____(Date)

1. The merger of the ____(merging)____ Credit Union into the __(continuing)__ Credit Union has been approved, effective ____(date)____.
2. As of that date, your shares (deposit) are no longer insured by the National Credit Union Administration.
3. Accounts in the __(continuing)__ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of_____.

Name of Credit Union
(Address)
_____

(c) A Federal credit union that is converting its charter to that of a nonfederally-insured credit union shall use the language contained in sub section (a) of this Section, but shall modify the language in (a) (1) to indicate that it is converting its charter and converting from Federal insurance.

§ 708b.303 Modifications to notice.

(a) Any modifications or additions to the notices or ballot concerning insurance coverage, and any additional communications concerning insurance coverage included with the notices or ballot, may be made with the approval of the Regional Director and, in the case of a state credit union, the appropriate state authority. Approval of such modifications, additions or additional communications will not be withheld unless it is determined that the credit union, by inclusion or omission of information, would materially mislead or misinform its membership.

(b) Federally-insured state credit unions may include additional language in the notice and ballot regarding state requirements for mergers, where appropriate.

Part 709

Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation

§ 709.0 Scope.

The rules and procedures in this part apply to charter revocations of federal credit unions under 12 U.S.C. 1787(a)(1)(A), (B), the involuntary liquidation and adjudication of creditor claims in all cases involving federally-insured credit unions, the treatment by the Board as conservator or liquidating agent of financial assets transferred in connection with a securitization or participation or of public funds held by a federally-insured credit union, and the allowance of prepayment fees to Federal Home Loan Banks under specified conditions. Remaining sections of this part are applicable to all federally insured credit unions. This part does not apply to share insurance claims arising out of the liquidation of a federally insured credit union. Insurance claims are decided pursuant to part 745 of this chapter.

§ 709.1 Definitions.

For the purposes of this Part, the following definitions apply:

(a) "General Counsel" means the General Counsel of the National Credit Union Administration or any attorney assigned to the General Counsel's staff.

(b) "Liquidating Agent" means the NCUA Board or person(s) appointed by it with delegated authority to carry out the liquidation of the credit union.

(c) "Insolvent" means insolvency as that term is defined in § 700.1(j) of these Regulations.

(d) "Claim" means a creditor's claim against the credit union in liquidation. This term does not include insurance claims arising out of the liquidation of a federally insured credit union. Insurance claims are decided pursuant to Part 745 of this Chapter.

(e) "Shareholder" means members, non-members, accountholders, or any other party or entity that is the owner of a share, share certificate or share draft account or the equivalent of such accounts under state law.

§ 709.2 NCUA Board as Liquidating Agent.

(a) The Board, as liquidating agent, by operation of law and without any conveyance or other instrument, act or deed, shall succeed to all the rights, titles, powers, and privileges of the credit union, and of its shareholders, officers, and directors, with respect to the credit union and its assets, and such shareholders, officers, or directors shall not thereafter have or exercise any such rights, powers, or privileges or act in connection with any assets or property of any nature of the credit union.

(b) The Board, as liquidating agent, shall take possession of and title to books, records, and assets of every description of such credit union to which such credit union has rights of possession and title to all offices and other facilities of such credit union.

§ 709.3 Challenge to Revocation of Charter and Involuntary Liquidation.

If a Federal credit union is determined to be insolvent and placed into liquidation pursuant to 12 U.S.C. § 1787, the Federal credit union may, not later than 10 days after the date on which the Board closes the credit union for liquidation, apply to the United States District Court for the judicial district in which the principal office of the credit union is located or the United States District Court for the District of Columbia for an order requiring the Board to show cause why it should not be prohibited from continuing such liquidation. Notwithstanding other provisions of this Part, the board of directors of the credit union may meet following the placing of the institution into liquidation for the sole purpose of considering and authorizing the filing of this action in the name of the credit union. No such action in the name of the credit union may be instituted without the authorization of the board of directors of the institution pursuant to a valid board of directors resolution. No credit union funds shall be available to pay expenses incurred in bringing a legal action to challenge the Board's liquidation action.

§ 709.4 Powers and Duties of Liquidating Agent.

(a) *Inventory of assets*—As soon as practicable after taking possession, the liquidating agent shall inventory the assets of such credit union as of the date of taking possession, showing the value as carried on the books of the credit union, and the security therefor, if any, a brief description of the assets and any security, and a record of the credit union's creditor and accounts liabilities.

(b) *Notice to creditors*—The liquidating agent shall promptly publish a notice to the credit union's creditors to present their claims, together with proof, to the liquidating agent by a date specified in the notice. This date shall be not less than 90 days after the publication of the notice. The liquidating agent shall republish such notice approximately one and two months, respectively, after the initial publication. At the time of initial publication, the liquidating agent shall mail a notice similar to the published notice to any creditor shown on the credit union's books at the last address appearing therein. If the liquidating agent discovers the name of a creditor whose name does not appear on the credit union's books, a notice similar to the published notice shall be mailed to such creditor within 30 days after the discovery of the name and address.

(c) *General*—The liquidating agent shall collect all obligations and money due such credit union and may, to the extent consistent with its appointment, do all things desirable or expedient in its discretion to wind up the affairs of the credit union including, but not limited to, the following:

(1) exercise all rights and powers of the credit union including, but not limited to, any rights and powers under any mortgage, deed of trust, chose in action, option, collateral note, contract, judgment or decree, or instrument of any nature;

(2) institute, prosecute, maintain, defend, intervene, and otherwise participate in any and all actions, suits, or other legal proceedings by and against the liquidating agent or the credit union or in which the liquidating agent, the credit union, or its creditors or shareholders, or any of them, shall have an interest, and in every way to represent the credit union, its shareholders and creditors, subject to the direction of General Counsel;

(3) employ on a salary or fee basis such persons as in the judgment of the liquidating agent are necessary or desirable to carry out its responsibilities and functions, including, but not limited to, appraisers and Certified Public Accountants, and pay the costs out of the assets of the liquidated credit union;

(4) employ or retain any attorney or attorneys designated by, or acceptable to, the General Counsel in connection with litigation or for legal advice and assistance, for the liquidation generally or in particular instances, and pay compensation and retainers of such attorney or attorneys, together with all expenses, including, but not limited to, the costs and expenses of any litigation, as approved by the General Counsel, out of the assets of the liquidated credit union;

(5) execute, acknowledge, and deliver any and all deeds, contracts, leases, assignments, bills of sale, releases, extensions, satisfactions, and other instruments necessary or proper for any purposes, including, but not limited to, the effectuation, termination, or transfer of real, personal or mixed property, or that shall be necessary or proper to liquidate the credit union, and any deed or other instrument executed pursuant to the authority hereby given shall be as valid and effective for all purposes as if the same had been executed as the act and deed of the credit union;

(6) with concurrence of General Counsel, disaffirm or repudiate any contract or lease to which the credit union is a party, the performance of which the liquidating agent, in his sole discretion, determines to be burdensome, and which disaffirmance or repudiation in the liquidating agent's sole discretion will promote the orderly administration of the credit union's affairs;

(7) deposit, withdraw, or transfer funds, and otherwise exercise complete control over all investment or depository accounts maintained by or for the credit union at financial depository or similar institutions;

(8) do such things, and have such rights, powers, privileges, immunities, and duties, whether or not otherwise granted in the rules and regulations of this Part 709, as shall be authorized, directed, conferred, or imposed from time to time by the Board, or as shall be conferred by the Federal Credit Union Act;

(9) exercise such other authority as is conferred by the Federal Credit Union Act; and

(10) where acting as liquidating agent for a state-chartered federally insured credit union, exercise all the rights, powers, and privileges granted by state law to such a liquidating agent.

(d) *Expenditure of funds of the liquidation*—The liquidating agent shall have power to:

(1) pay all costs and expenses of the liquidation as determined by the liquidating agent;

(2) pay off and discharge taxes and liens;

(3) pay out and expend such sums as are deemed necessary or advisable for or in connection with the preservation, maintenance, conservation, protection, remodeling, repair, rehabilitation, or improvement of any asset or property of any nature of the credit union or the liquidating agent;

(4) pay off and discharge any assessments, liens, claims, or charges of any kind against any asset or property of any nature on which the credit union or the liquidating agent has a lien by way of mortgage, deed of trust, pledge, or otherwise, or in which the credit union or liquidating agent has any interest;

(5) settle, compromise, or obtain the release of, for cash or other consideration, claims and demands against the credit union or the liquidating agent; and

(6) indemnify its employees and agents from the assets of the credit union against liabilities incurred in the good faith performance of their duties.

(e) *Assets, claims, and contracts*—The liquidating agent shall have power to:

(1) sell for cash or on terms, exchange, assign, or otherwise dispose of, in whole or in part, any or all of the assets and property of the credit union, real, personal and mixed, tangible and intangible, of any nature, including any mortgage, deed of trust, chose in action, bond, note, contract, judgment, or decree, share or certificate of share of stock or debt, owing to the credit union or the liquidating agent; and

(2) surrender, abandon, and release any chose in action, or other assets or property of any nature, whether the subject of pending litigation or not, and settle, compromise, modify, or release, for cash or other consideration, claims and demands in favor of the credit union or the liquidating agent.

§ 709.5 Payout Priorities in Involuntary Liquidation.

(a) Claimants whose claims are secured shall receive their security. To the extent their respective claims exceed the value of the security for those claims, as determined to the satisfaction of the liquidating agent, they shall each have an unsecured claim against the credit union having priority as provided in paragraph (b) of this section.

(b) Unsecured claims against the liquidation estate that are proved to the satisfaction of the liquidating agent shall have priority in the following order:

(1) administrative costs and expenses of liquidation;

(2) claims for wages and salaries, including vacation, severance, and sick leave pay;

(3) taxes legally due and owing to the United States or any state or subdivision thereof;

(4) debts due and owing the United States, including the National Credit Union Administration;

(5) general creditors, and secured creditors (to the extent that their respective claims exceed the value of the security for those claims);

(6) shareholders to the extent of their respective uninsured shares and the National Credit Union Share Insurance Fund to the extent of its payment of share insurance;

(7) in a case involving liquidation of a corporate credit union, membership capital of corporate credit unions;

(8) in a case involving liquidation of a low-income designated credit union, any outstanding secondary capital accounts issued pursuant to the authority of §§ 701.34 or 741.204(c) of this chapter, and

(9) in a case involving liquidation of a corporate credit union, paid-in capital.

(c) Priorities are to be based on the circumstances that exist on the date of liquidation.

(d) If the repudiation or disaffirmance of any contract or lease gives rise to a claim for damages, such claim shall be considered a general creditor claim under paragraph (b)(5) of this section and not a cost or expense of liquidation under paragraph (b)(1) of this section.

(e) All unsecured claims of any category or class or priority described in paragraphs (b)(1) through (b)(7) of this section shall be paid in full, or provisions made for such payment, before any claims of lesser priority are paid. If there are insufficient funds to pay all claims of a category or class, payment shall be made pro rata. Notwithstanding anything to the contrary herein, the liquidating agent may, at any time, and from time to time, prior to the payment in full of all claims of a category or class with higher priority, make such distributions to claimants in priority categories described in paragraphs (b)(1), (b)(2), (b)(3), (b)(4),

and (b)(5) of this section as the liquidating agent believes are reasonably necessary to conduct the liquidation, provided that the liquidating agent determines that adequate funds exist or will be recovered during the liquidation to pay in full all claims of any higher priority. If a surplus remains after making distribution in full on all allowed claims described in paragraphs (b)(1) through (b)(9) of this section, such surplus shall be distributed pro rata to the credit union's shareholders.

§ 709.6 Initial Determination of Creditor Claims by the Liquidating Agent.

(a)(1) Any party wishing to submit a claim against the liquidated credit union must submit a written proof of claim in accordance with the requirements set forth in the notice to creditors. A failure to submit a written claim within the time provided in the notice to creditors shall be deemed a waiver of said claim and claimant shall have no further rights or remedies with respect to such claim.

(2) Notwithstanding paragraph (a)(1) of this section, the liquidating agent may, at his discretion, consider an untimely claim provided the following two criteria are present: (i) the claimant did not receive notice of the appointment of the liquidating agent in time to file a claim before the date provided for in the notice; and (ii) the claim is filed in time to permit payment of the claim.

(b) The liquidating agent may require submission of supplemental evidence by the claimant and by interested parties in the event of a dispute concerning a claim against any asset of the liquidated credit union. In requiring the submission of supplemental evidence, the liquidating agent may set such limitations of time, scope, and size as the liquidating agent deems reasonable in the circumstances, and may refuse to include in the record submissions or portions of submissions not in compliance with such limitations or requirements. The liquidating agent shall compile such written record of a claim or dispute as, in its discretion, is deemed sufficient to provide a reasonable basis for allowing or disallowing a claim or resolving a dispute. This written record shall be considered the administrative record.

(c) The liquidating agent shall determine whether to allow or disallow a claim and shall notify the claimant within 180 days from the date a claim against a credit union is filed pursuant to paragraph (a)(1) of this section. This 180-day period may be extended by written agreement between the claimant and the liquidating agent. Failure by the liquidating agent to determine a claim and notify the claimant within the 180-day period or, if the period is extended, within the extended period, shall be deemed a denial of the claim.

(d) If a claim or any portion thereof is disallowed, the notice to the claimant shall contain a statement of the reasons for the disallowance and an explanation of appeal rights pursuant to Section 709.7 of this Part.

(e) Notice of any determination with respect to a claim shall be sufficient if mailed to the most recent address of the claimant which appears:

(1) on the credit union's books;

(2) in the claim filed by the claimant; or

(3) in the documents submitted in the proof of claim.

(f) In the event the liquidating agent disallows all or part of a claim, the liquidating agent shall file with the Board, or its designated agent, a report of its determination. This report shall become part of the record and shall include the notice to the claimant and findings on all issues raised and decided by the liquidating agent.

§ 709.7 Procedures for Appeal of Initial Determination.

In order to appeal all or part of an initial decision which disallows a claim, in whole or in part, a claimant must, within 60 days of the mailing of the initial determination, file an administrative appeal pursuant to Section 709.8 of this Part, or file suit against the liquidated credit union in the United States District Court for the District of Columbia or in the United States District Court having jurisdiction over the place where the credit union's principal place of business is located, or continue an action commenced before the appointment of the liquidating agent. If the claimant does not appeal or file or continue a suit, any disallowance shall be final and the claimant shall have no further rights or remedies with respect to such claim.

§ 709.8 Administrative Appeal of the Initial Determination.

(a) *General*—A claimant requesting an administrative appeal may request review pursuant to any of the procedures listed in paragraphs (b) or (c) of this section. Any appeal of the initial deter-

mination must be in writing and must specify what type of appeal the claimant requests. The determination of whether to agree to a request for administrative appeal shall rest solely with the Board, which shall notify the claimant of its decision in writing. The 60-day period for filing a lawsuit in United States District Court, provided for in Section 709.7 of this Part, shall be tolled from the date of claimant's request for an administrative appeal to the date of the Board's decision regarding that request.

(b) *Hearing on the record*—Except as provided herein, any hearing requested pursuant to this section shall be conducted in accordance with the provisions of Subpart A, Part 747, of this Chapter. The Board shall render a final decision with respect to such claim after consideration of the hearing record and recommended decision. The Board's determination shall be subject to judicial review under Chapter 7 of Title 5, United States Code. Any claimant seeking judicial review of the Board's final decision under this paragraph must file a petition in the court of appeals for the circuit in which the principal office of the credit union is located, or in the United States Court of Appeals for the District of Columbia Circuit, within 30 days of the date of the Board's final decision. If a claimant does not file a petition before the end of the 30-day period, the Board's decision shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(1) *Burden of proof*—In any hearing on the record, the burden of proof to establish entitlement to any modification of the initial determination shall rest solely upon the claimant.

(2) *Order of procedure*—In any hearing on the record, at the time for opening arguments, counsel for the claimant shall argue first, and at the time for closing arguments, counsel for the claimant shall argue last.

(c) *Alternative dispute resolution*—Paragraphs (c) (1) and (2) of this section list alternatives for dispute resolution which may be available at the discretion of the Board. From time to time, the NCUA Board may authorize additional alternative dispute resolution processes.

(1) *Appeal to the Board*—Pursuant to this paragraph (c)(1), the claimant may file an appeal with the NCUA Board within the time provided for in Section 709.7. The appeal must be in writing and filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. There shall be no personal appearance before the Board in connection with an appeal under this paragraph (c)(1).

(i) *Content of appeal*—Any appeal must include:

(A) a statement of the facts on which the appeal is based;

(B) a statement of the basis for the initial determination to which the claimant objects and the alleged error in such determination, including citations to applicable statutes and regulations;

(C) any other evidence relied upon by the claimant which was not previously provided to the liquidating agent.

(ii) *Procedures for review of the appeal*—

(A) Within 60 days of the date of the Board's receipt of an appeal, pursuant to paragraph (c)(1) of this section, the Board may request in writing that the claimant submit supplemental evidence in support of its appeal. If additional evidence is requested, the claimant shall have 45 days from the date of issuance of such request to provide such additional information. Failure by the claimant to provide such additional information may, as determined solely by the Board, result in denial of the claimant's appeal.

(B) Within 60 days from the date of the Board's receipt of an appeal, pursuant to paragraph (c)(1) of this section, the claimant may amend or supplement the appeal in writing. In the event the claimant does amend or supplement the appeal, the provisions of paragraph (c)(1)(ii)(A) of this section, with respect to requests for additional information and responses to such requests, shall apply with equal force to any such amendment or supplement to an appeal.

(iii) *Determination on appeal*—

(A) Within 180 days from the date of receipt of an appeal by the Board, the Board shall issue a decision allowing or disallowing claimant's appeal.

(B) The decision by the Board on appeal shall be provided to the claimant in writing, stating the reasons for the decision, and shall constitute a final agency decision regarding the claimant's claim.

(C) Failure by the Board to issue a decision on appeal of the claimant's claim within the 180-day period provided for under paragraph (c)(1)(iii)(A) shall be deemed to be denial of such appeal for the purposes of paragraph (c)(1)(iv) of this section.

(iv) *Judicial review*—

(A) For the purposes of seeking judicial review of actions taken pursuant to paragraph (c)(1) of this section, only a determination on appeal issued by the NCUA Board pursuant to this section shall constitute a final determination regarding a claim.

(B) A final determination by the Board is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States Court of Appeals for the District of Columbia or the court of appeals for the Federal judicial circuit where the credit union's principal place of business is located. Any request for judicial review under this subparagraph must be filed within 60 days of the date of the Board's final decision. If any claimant fails to file before the end of the 60-day period, the Board's decision shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(2) The following additional procedures for dispute resolution may be made available at the sole discretion of the Board: mediation; nonbinding arbitration; and neutral fact finding.

§ 709.9 Expedited Determination of Creditor Claims.

(a) *General*—The provisions of this section establish procedures under which claimants may request expedited relief in lieu of the procedures set forth in Section 709.6 of this Part. A claimant shall be entitled to expedited determination of a claim only upon a showing that there exists a legally valid and enforceable or perfected security interest in assets of the liquidated credit union and that irreparable injury will occur if the routine claims procedure is followed.

(b) *Filing of request for expedited relief*—All requests for expedited relief must be filed within 30 days from the date of mailing, by the liquidating agent, of the notice to the creditor concerned. The request shall be deemed to be filed when received by the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. A copy of the request must be simultaneously served upon the liquidating agent for the credit union concerned. There shall be no right of personal appearance before the Board in connection with any claim submitted under this paragraph.

(c) *Content of request for expedited relief*—Any Request for Expedited Relief must contain the following:

(1) a clear and concise statement of the facts and issues on which the request is based;

(2) a clear and concise statement describing the nature of any security interests in any assets of the credit union;

(3) a clear and concise statement of the probable, imminent and irreparable harm likely to occur if expedited relief is not granted;

(4) an assessment of the likelihood of success on the merits of the underlying claim, including statutory citations and relevant documentation supporting the merits of the claim;

(5) any other relevant documentation that supports the request;

(6) citations to applicable statutes, regulations, or other legal authority; and

(7) a signed statement certifying that a copy of the request has been mailed or hand delivered to the liquidating agent on or before the day that the request was filed with the Board.

(d) *Burden of proof*—The burden of proving entitlement to expedited relief rests at all times with the requester.

(e) *Additional information*—The Board may order the filing of additional information and/or documentation in order to make its determination. Such filing shall be on a date certain, and failure to provide the additional documentation or information may constitute the sole grounds for denial of the request.

(f) *Decision*—Before the end of the 90-day period beginning on the date a request is filed, the Board shall render its decision and provide it to the requester. The Board will determine whether to grant expedited review and allow or disallow the claim or whether such claim should be resolved pursuant to the claims process described in Section 709.6 of this Part.

(1) *Expedited review denied*—A decision by the Board that expedited review is not appropriate shall be final and the claim shall be decided pursuant to the claims adjudication process set forth in Section 709.6 of this Part.

(2) *Expedited review granted*—If expedited review is granted, the Board shall decide the claim. If the claim is disallowed, in whole or part, the decision shall contain a statement of each reason for the disallowance and the procedure for obtaining judicial review.

(g) *Period for filing or renewing suit*—Any claimant who files a request for expedited relief shall be permitted to file a suit, or to continue a suit filed before the appointment of the liquidating agent, seeking a determination of the claimant's

rights with respect to its security interest after the earlier of:

(1) the end of the 90-day period beginning on the date of the filing of a request for expedited relief; or

(2) the date the Board denies all or part of the claim.

§ 709.10 Treatment by conservator or liquidating agent of financial assets transferred in connection with a securitization or participation.

(a) *Definitions.* (1) *Beneficial interest* means debt or equity (or mixed) interests or obligations of any type issued by a special purpose entity that entitle their holders to receive payments that depend primarily on the cash flow from financial assets owned by the special purpose entity.

(2) *Financial asset* means cash or a contract or instrument that conveys to one entity a contractual right to receive cash or another financial instrument from another entity.

(3) *Legal isolation* means that transferred financial assets have been put presumptively beyond the reach of the transferor, its creditors, a trustee in bankruptcy, or a receiver, either by a single transaction or a series of transactions taken as a whole.

(4) *Participation* means the transfer or assignment of an undivided interest in all or part of a loan or a lease from a seller, known as the "lead," to a buyer, known as the "participant," without recourse to the lead, under an agreement between the lead and the participant. *Without recourse* means that the participation is not subject to any agreement that requires the lead to repurchase the participant's interest or to otherwise compensate the participant due to a default on the underlying obligation.

(5) *Securitization* means the issuance by a special purpose entity of beneficial interests:

(i) The most senior class of which at time of issuance is rated in one of the four highest categories assigned to long-term debt or in an equivalent short-term category (within either of which there may be sub-categories or gradations indicating relative standing) by one or more nationally recognized statistical rating organizations; or

(ii) Which are sold in transactions by an issuer not involving any public offering for purposes of section 4 of the Securities Act of 1933, as amended, or in transactions exempt from registration under such Act under 17 CFR 230.91 through 230.905 (Regulation S) thereunder (or any successor regulation).

(6) *Special purpose entity* means a trust, corporation, or other entity demonstrably distinct from the federally-insured credit union that is primarily engaged in acquiring and holding (or transferring to another special purpose entity) financial assets, and in activities related or incidental thereto, in connection with the issuance by such special purpose entity (or by another special purpose entity that acquires financial assets directly or indirectly from such special purpose entity) of beneficial interests.

(b) The Board, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. 1787(c), will not reclaim, recover, or recharacterize as property of the credit union or the liquidation estate any financial assets transferred to another party by a federally-insured credit union in connection with a securitization or participation, provided that a transfer meets all conditions for sale accounting treatment under generally accepted accounting principles, other than the "legal isolation" condition addressed by this section.

(c) Paragraph (b) of this section will not apply unless the federally-insured credit union received adequate consideration for the transfer of financial assets at the time of the transfer, and the documentation effecting the transfer of financial assets reflects the intent of the parties to treat the transaction as a sale, and not as a secured borrowing, for accounting purposes.

(d) Paragraph (b) of this section will not be construed as waiving, limiting, or otherwise affecting the power of the Board, as conservator or liquidating agent, to disaffirm or repudiate any agreement imposing continuing obligations or duties upon the federally-insured credit union in conservatorship or the liquidation estate.

(e) Paragraph (b) of this section will not be construed as waiving, limiting or otherwise affecting the rights or powers of the Board to take any action or to exercise any power not specifically limited by this section, including, but not limited to, any rights, powers or remedies of the Board regarding transfers taken in contemplation of the credit union's insolvency or with the intent to hinder, delay, or defraud the credit union or the creditors of such credit union, or that is a fraudulent transfer under applicable law.

(f) The Board will not seek to avoid an otherwise legally enforceable securitization agreement or

participation agreement executed by a federally-insured credit union solely because such agreement does not meet the "contemporaneous" requirement of sections 207(b)(9) and 208(a)(3) of the Federal Credit Union Act.

(g) This section may be repealed by the NCUA upon 30 days notice and opportunity for comment provided in the **Federal Register**, but any such repeal or amendment will not apply to any transfers of financial assets made in connection with a securitization or participation that was in effect before such repeal or modification. For purposes of this paragraph, a securitization would be in effect on the earliest date that the most senior level of beneficial interests is issued, and a participation would be in effect on the date that the parties executed the participation agreement.

§ 709.11 Treatment by conservator or liquidating agent of collateralized public funds.

An agreement to provide for the lawful collateralization of funds of a federal, state, or local governmental entity or of any depositor or member referred to in section 207(k)(2)(A) of the Act will not be deemed to be invalid under sections 207(b)(9) and 208(a)(3) of the Act solely because such agreement was not executed contemporaneously with the acquisition of collateral or with any changes, increases, or substitutions in the collateral made in accordance with such agreement, provided the following conditions are met:

(a) The agreement was undertaken in the ordinary course of business, not in contemplation of insolvency, and with no intent to hinder, delay or defraud the credit union or its creditors;

(b) The secured obligation represents a bona fide and arm's length transaction;

(c) The secured party or parties are not insiders or affiliates of the credit union;

(d) The grant or creation of the security interest was for adequate consideration; and,

(e) The security agreement evidencing the security interest is in writing, was approved by the credit union's board of directors, and has been continuously an official record of the credit union from the time of its execution.

§ 709.12 Prepayment Fees to Federal Home Loan Bank.

The Board as conservator or liquidating agent of a federally-insured credit union in receipt of any extension of credit from a Federal Home Loan Bank will allow a claim for a prepayment fee by the Bank if:

(a) The claim is made pursuant to a written contract that provides for a prepayment fee but the prepayment fee allowed by the Board will not exceed the present value of the loss attributable to the difference between the contract rate of the secured borrowing and the reinvestment rate then available to the Bank; and

(b) The indebtedness owed to the Bank is secured by sufficient collateral in which a perfected security interest in favor of the Bank exists or as to which the Bank's security interest is entitled to priority under section 306(d) of the Competitive Equality Banking Act of 1987, 12 U.S.C. 1430(e) footnote (1), or otherwise so that the aggregate of the outstanding principal on the advances secured by the collateral, the accrued but unpaid interest on the outstanding principal and the prepayment fee applicable to the advances can be paid in full from the amounts realized from the collateral. For purposes of this paragraph, the adequacy of the collateral will be determined as of the date the prepayment fees are due and payable under the terms of the written contract.

§ 709.13 Treatment of swap agreements in liquidation or conservatorship.

The Board has determined that a swap agreement, as defined in the Federal Deposit Insurance Act at 12 U.S.C. 1821(e)(8)(D)(vi), is a qualified financial contract for purposes of the special treatment for qualified financial contracts provided in 12 U.S.C. 1787(c). Any master agreement for any swap agreement, together with all supplements to such master agreement, will be treated as one swap agreement.

Part 710

Voluntary Liquidation

§ 710.0 Scope.

This Part prescribes the requirements that must be followed to accomplish the voluntary liquidation of a Federal credit union. Federally insured state credit unions are only subject to the notification requirement provided in § 710.9; voluntary liquidation is to be accomplished in accordance with state law or procedures established by the state regulatory authority.

§ 710.1 Definitions.

For the purpose of this Part, the following definitions apply:

(a) *Voluntary liquidation* means the dissolution of a solvent Federal credit union with the assets being sold or collected, liabilities paid, and shares distributed under the direction of the board of directors or its duly appointed liquidating agent.

(b) *Liquidation date* means the date the members vote to approve liquidation.

(c) *Liquidating agent* means the person or persons, including any legally recognized entity, appointed by the board of directors to liquidate the Federal credit union.

§ 710.2 Responsibility for Conducting Voluntary Liquidation.

(a) The board of directors shall be responsible for conserving the assets, for expediting the liquidation, and for equitable distribution of the assets to the members.

(b) After voting to present the question of liquidation to the members, the board of directors may appoint a liquidating agent and delegate all or part of the board's responsibility to such agent and authorize reasonable compensation for the services provided.

(c) The board of directors shall determine that the liquidating agent and all persons who handle or have access to funds of the Federal credit union are adequately covered by surety bond and that either such coverage remains in effect, or the discovery period is extended, for at least four months after final distribution of assets.

(d) Within three days after the decision of the board of directors to submit the question of liquidation to the members, the Regional Director will be notified in writing, setting forth in detail the reasons for the proposed action. A balance sheet and income statement as of the previous month-end will be included with the notification. During the liquidation process, financial statements will be submitted to the Regional Director as requested.

(e) Promptly after the decision to present the question of liquidation to the members, the board of directors or liquidating agent shall develop a written plan for the liquidation of the assets and payment of shares (liquidation plan). The plan should provide for the liquidation of assets and payment of creditors and shareholders within one year of the liquidation date. If the liquidation period is projected to exceed one year, an explanation must be provided in the liquidation plan. A copy of the liquidation plan will be mailed to the Regional Director within 30 days of the date the board of directors votes to present the question of liquidation to the members.

§ 710.3 Approval of the Liquidation Proposal by Members.

(a) When the board of directors decides to present the question of liquidation to the members, it shall act promptly to obtain the members' approval. The members shall be given advance notice of the membership meeting at which the liquidation proposal is to be submitted, in accordance with the provisions of Article V of the Federal Credit Union Bylaws. The notice shall:

(1) Inform members that they have the right to vote on the liquidation proposal in person at the membership meeting called for that purpose or by written ballot to be received no later than the time and date indicated on the notice.

(2) Include or be accompanied by a ballot for the liquidation proposal.

(b) The liquidation proposal must be approved by the affirmative vote of a majority of the Federal credit union members who vote on the proposal.

(c) If the members do not approve the liquidation, the board of directors, or if delegated the authority, the liquidating agent, must decide within seven days whether the Federal credit union should resume operations or, if good cause exists, to resubmit the question of liquidation to the members.

(d) If the members approve the liquidation, neither the members nor the board of directors may rescind the decision to liquidate unless the Regional Director concurs in the rescission.

(e) The Regional Director will be notified in writing of the results of the membership vote on the voluntary liquidation proposal within three days of the date of the vote.

§ 710.4 Transaction of Business During Liquidation.

(a) Immediately upon decision by the board of directors to present the question of liquidation to the members, payments on shares, withdrawal of shares (except for transfer of shares to loans and interest), transfer of shares to another share account, granting of loans, and making of investments other than short-term investments shall be suspended pending action by the members on the proposal to liquidate. Collection of loans and interest, payment of necessary expenses, clearing of share drafts and credit card charges will continue.

(b) Upon approval of the members, payments on shares, withdrawal of shares (except for transfer of shares to loans and interest), transfer of shares to another share account, granting of loans, and making of investments other than short-term investments shall be discontinued permanently. Collection of loans and interest and payment of necessary expenses will continue during the period of liquidation. Members will be notified to discontinue the use of share drafts and credit cards, and items will not be cleared 15 days from the liquidation date.

(c) Approval of the Regional Director must be obtained prior to consummating any sale of assets which would not provide sufficient funds to pay shareholders at par.

§ 710.5 Notice of Liquidation to Creditors.

(a) When approval for liquidation is obtained from the members, the board of directors or the liquidating agent shall cause notice to be given to creditors to present their claims.

(1) Federal credit unions with assets in excess of $5 million as of the month-end prior to the liquidation date shall publish the notice once a week in each of three successive weeks, in a newspaper of general circulation, in each county in which the Federal credit union maintains an office or branch for the transaction of business on the liquidation date. The first notice shall be published within seven days of the liquidation date.

(2) Federal credit unions with assets in excess of $500,000 but less than $5 million as of the month-end prior to the liquidation date shall publish the notice once, in a newspaper of general circulation, in each county in which the Federal credit union maintains an office or branch for the transaction of business on the liquidation date. The notice shall be published within seven days of the liquidation date.

(3) Federal credit unions with assets less than $500,000 as of the month-end prior to the liquidation date shall not be required to publish the notice.

(b) Within 10 days of the liquidation date, a copy of the notice of liquidation shall be mailed to all creditors reflected on the records of the Federal credit union.

(c) Creditors shall be provided 30 days from the liquidation date to submit their claims.

§ 710.6 Distribution of Assets.

(a) With the approval of the Regional Director, a partial pro rata distribution of the Federal credit union's assets may be made to its members from cash funds available on authorization by the board of directors or liquidating agent. Payment of a partial distribution may exclude member accounts of less than $25.00.

(b) After all assets of the Federal credit union have been converted to cash or found to be worthless and all loans and debts owing to it have been collected or found to be uncollectible and all obligations of the Federal credit union have been paid, with the exception of shares due its members, the books shall be closed and the pro rata distribution to the members shall be computed. The computation shall be based on the total amount in each share account.

(c) Promptly after the pro rata distribution to members has been computed, checks shall be drawn for the amounts to be distributed to each

member. The checks shall be mailed to the members at their last known address or handed to them in person.

(d) Unclaimed share accounts, unpaid claims, and unpaid claims of members or creditors who failed to cash their final distribution checks shall be trusteed or escheated in accordance with the laws of the state in which the member or creditor resides.

(e) The Regional Director will be notified in writing within three days when the final distribution of assets to the members is started.

§ 710.7 Retention of Records.

(a) The board of directors or liquidating agent shall appoint a custodian for the Federal credit union's records which are to be retained after the final distribution of assets.

(b) All records of the liquidated Federal credit union necessary to establish that creditors were paid and that assets were equitably distributed to the members shall be retained by the custodian for a period of five years following the date of charter cancellation.

§ 710.8 Certificate of Dissolution and Liquidation.

Within 120 days after the final distribution of assets to members is started, a duly executed Certificate of Dissolution and Liquidation shall be filed with the Regional Director.

§ 710.9 Federally Insured State Credit Unions.

A federally insured state credit union will notify the Regional Director in writing within three days after the board of directors' decision to liquidate is made. A balance sheet and income statement as of the previous month-end and a copy of any liquidation plan will be included with the notification to the Regional Director.

Part 711

Management Official Interlocks

§ 711.1 Authority, Purpose and Scope.

(a) *Authority.* This part is issued under the provisions of the Depository Institution Management Interlocks Act (Interlocks Act) (12 U.S.C. 3201 *et seq*).

(b) *Purpose.* The purpose of the Interlocks Act and this part is to foster competition by generally prohibiting a management official from serving two nonaffiliated depository organizations in situations where the management interlock likely would have an anticompetitive effect.

(c) *Scope.* This part applies to management officials of federally insured credit unions. Section 711.4(c) exempts a management official of a credit union from the prohibitions of the Interlocks Act when the individual serves as a management official of another credit union. Therefore, the Interlocks Act prohibitions contained in this part only apply to a management official of a credit union when that individual also serves as a management official of another type of depository organization (usually a bank or thrift).

§ 711.2 Definitions.

For purposes of this part, the following definitions apply:

(a) *Affiliate.* (1) The term *affiliate* has the meaning given in section 202 of the Interlocks Act (12 U.S.C. 3201). For purposes of that section 202, shares held by an individual include shares held by members of his or her immediate family. "Immediate family" means spouse, mother, father, child, grandchild, sister, brother, or any of their spouses, whether or not any of their shares are held in trust.

(2) For purposes of section 202(3)(B) of the Interlocks Act (12 U.S.C. 3201(3)(B)), an affiliate relationship involving a depository institution based on common ownership does not exist if the appropriate federal supervisory agency determines, after giving the affected persons the opportunity to respond, that the asserted affiliation was established in order to avoid the prohibitions of the Interlocks Act and does not represent a true commonality of interest between the depository organizations. In making this determination, the appropriate Federal supervisory agency considers, among other things, whether a person, including members of his or her immediate family, whose shares are necessary to constitute the group owns a nominal percentage of the shares of one of the organizations and the percentage is substantially disproportionate to that person's ownership of shares in the other organization.

(b) *Area median income* means:

(1) The median family income for the metropolitan statistical area (MSA), if a depository organization is located in an MSA; or

(2) The statewide nonmetropolitan median family income, if a depository organization is located outside an MSA.

(c) *Community* means a city, town, or village, and contiguous or adjacent cities, towns, or villages.

(d) *Contiguous or adjacent cities, towns, or villages* means cities, towns, or villages whose borders touch each other or whose borders are within 10 road miles of each other at their closest points. The property line of an office located in an unincorporated city, town, or village is the boundary line of that city, town, or village for the purpose of this definition.

(e) *Depository holding company* means a bank holding company or a savings and loan holding company (as more fully defined in section 202 of the Interlocks Act (12 U.S.C. 3201) having its principal office located in the United States.

(f) *Depository institution* means a commercial bank (including a private bank), a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union, chartered under the laws of the United States and having a principal office located in the United States. Additionally, a United States office, including a branch or agency, of a foreign commercial bank is a depository institution.

(g) *Depository institution affiliate* means a depository institution that is an affiliate of a depository organization.

(h) *Depository organization* means a depository institution or a depository holding company.

(i) *District bank* means any State bank operating under the Code of Law of the District of Columbia.

(j) *Low- and moderate-income areas* means census tracts (or, if an area is not in a census tract, block numbering areas delineated by the United States Bureau of the Census) where the median family income is less than 100 percent of the area median income.

(k) *Management official.* (1) The term *management official* means:

(i) A director;

(ii) An advisory or honorary director of a depository institution with total assets of $100 million or more;

(iii) A senior executive officer as that term is defined in 12 CFR 701.14(b)(2), or a person holding an equivalent position regardless of title;

(iv) A branch manager;

(v) A trustee of a depository organization under the control of trustees; and

(vi) Any person who has a representative or nominee serving in any of the capacities in this paragraph (m)(1).

(2) The term *management official* does not include:

(i) A person whose management functions relate exclusively to the business of retail merchandising or manufacturing;

(ii) A person whose management functions relate principally to the business outside the United States of a foreign commercial bank; or

(iii) A person described in the provisions of section 202(4) of the Interlocks Act (12 U.S.C. 3201(4)) (referring to an officer of a State-chartered savings bank, cooperative bank, or trust company that neither makes real estate mortgage loans nor accepts savings).

(l) *Office* means a principal or branch office of a depository institution located in the United States. *Office* does not include a representative office of a foreign commercial bank, an electronic terminal, or a loan production office.

(m) *Person* means a natural person, corporation, or other business entity.

(n) *Relevant metropolitan statistical area (RMSA)* means an MSA, a primary MSA, or a consolidated MSA that is not comprised of designated primary MSAs to the extent that these terms are defined and applied by the Office of Management and Budget.

(o) *Representative or nominee* means a natural person who serves as a management official and has an obligation to act on behalf of another person with respect to management responsibilities. NCUA will find that a person has an obligation to act on behalf of another person only if the first person has an agreement, express or implied, to act on behalf of the second person with respect to management responsibilities. NCUA will determine, after giving the affected persons an opportunity to respond, whether a person is a *representative or nominee.*

(p) *Total assets.* (1) The term *total assets* means assets measured on a consolidated basis and reported in the most recent fiscal year-end Consolidated Report of Condition and Income.

(2) The term *total assets* does not include:

(i) Assets of a diversified savings and loan holding company as defined by section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) other than the assets of its depository institution affiliate;

(ii) Assets of a bank holding company that is exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956 pursuant to an order issued under section 4(d) of that Act (12 U.S.C. 1843(d)) other than the assets of its depository institution affiliate; or

(iii) Assets of offices of a foreign commercial bank other than the assets of its United States branch or agency.

(q) *United States* includes any State or territory of the United States of America, the District of Columbia, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

§ 711.3 Prohibitions.

(a) *Community.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same community.

(b) *RMSA.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same RMSA and each depository organization has total assets of $20 million or more.

(c) *Major Assets.* A management official of a depository organization with total assets exceeding

$2.5 billion (or any affiliate thereof) may not serve at the same time as a management official of an unaffiliated depository organization with total assets exceeding $1.5 billion (or any affiliate thereof), regardless of the location of the two depository organizations. The NCUA will adjust these thresholds, as necessary, based on year-to-year change in the average of the Consumer Price Index for the Urban Wage Earners and Clerical Workers, not seasonally adjusted, with rounding to the nearest $100 million. The NCUA will announce the revised thresholds by publishing a notice in the **Federal Register**.

§ 711.4 Interlocking relationships permitted by statute.

The prohibitions of § 711.3 do not apply in the case of any one or more of the following organizations or to a subsidiary thereof:

(a) A depository organization that has been placed formally in liquidation, or which is in the hands of a receiver, conservator, or other official exercising a similar function;

(b) A corporation operating under section 25 or section 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.* and 12 U.S.C. 611 *et seq.*, respectively) (Edge Corporations and Agreement Corporations);

(c) A credit union being served by a management official of another credit union;

(d) A depository organization that does not do business within the United States except as an incident to its activities outside the United States;

(e) A State-chartered savings and loan guaranty corporation;

(f) A Federal Home Loan Bank or any other bank organized solely to serve depository institutions (a bankers' bank) or solely for the purpose of providing securities clearing services and services related thereto for depository institutions and securities companies;

(g) A depository organization that is closed or is in danger of closing as determined by the appropriate Federal depository institutions regulatory agency and is acquired by another depository organization. This exemption lasts for five years, beginning on the date the depository organization is acquired; and

(h)(1) A diversified savings and loan holding company (as defined in section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) with respect to the service of a director of such company who also is a director of an unaffiliated depository organization if:

(i) Both the diversified savings and loan holding company and the unaffiliated depository organization notify their appropriate Federal depository institutions regulatory agency at least 60 days before the dual service is proposed to begin; and

(ii) The appropriate regulatory agency does not disapprove the dual service before the end of the 60-day period.

(2) The NCUA Board or its designee may disapprove a notice of proposed service if it finds that:

(i) The service cannot be structured or limited so as to preclude an anticompetitive effect in financial services in any part of the United States;

(ii) The service would lead to substantial conflicts of interest or unsafe or unsound practices; or

(iii) The notificant failed to furnish all the information required by NCUA.

(3) The NCUA Board or its designee may require that any interlock permitted under this paragraph (h) be terminated if a change in circumstances occurs with respect to one of the interlocked depository organizations that would have provided a basis for disapproval of the interlock during the notice period.

§ 711.5 Small market share exemption.

(a) *Exemption.* A management interlock that is prohibited by § 711.3(a) or § 711.3(b) is permissible, provided:

(1) The interlock is not prohibited by § 711.3(c); and

(2) The depository organizations (and their depository institution affiliates) hold, in the aggregate, no more than 20% of the deposits, in each RMSA or community in which the depository organizations (or their depository institution affiliates) are located. The amount of deposits will be determined by reference to the most recent annual Summary of Deposits published by the FDIC. This information is available on the Internet at http://www.fdic.gov.

(b) *Confirmation and records.* Each depository organization must maintain records sufficient to support its determination of eligibility for the exemption under paragraph (a) of this section, and must reconfirm that determination on an annual basis.

§ 711.6 General exemption.

(a) *Exemption.* NCUA may, by agency order issued following receipt of an application, exempt an interlock from the prohibitions in § 711.3, if NCUA finds that the interlock would not result in a monopoly or substantial lessening of competition, and would not present other safety and soundness concerns.

(b) *Presumptions.* In reviewing applications for an exemption under this section, NCUA will apply a rebuttable presumption that an interlock will not result in a monopoly or substantial lessening of competition if the depository organization seeking to add a management official:

(1) Primarily serves, low- and moderate-income areas;

(2) Is controlled or managed by persons who are members of a minority group or women;

(3) Is a depository institution that has been chartered for less than two years; or

(4) Is deemed to be in "troubled condition" as defined in § 701.14(b)(3) of this chapter.

(c) *Duration.* Unless a shorter expiration period is provided in the NCUA approval, an exemption permitted by paragraph (a) of this section may continue so long as it would not result in a monopoly or substantial lessening of competition, or be unsafe or unsound. If the NCUA grants an interlock exemption in reliance upon a presumption under paragraph (b) of this section, the interlock may continue for three years, unless otherwise provided in the approval.

§ 711.7 Change in circumstances.

(a) *Termination.* A management official shall terminate his or her service if a change in circumstances causes the service to become prohibited. A change in circumstances may include, but is not limited to, an increase in asset size of an organization, a change in the delineation of the RMSA or community, the establishment of an office, an increase in the aggregate deposits of the depository organization, or an acquisition, merger, consolidation, or reorganization of the ownership structure of a depository organization that causes a previously permissible interlock to become prohibited.

(b) *Transition period.* A management official described in paragraph (a) of this section may continue to serve the depository organization involved in the interlock for 15 months following the date of the change in circumstances. NCUA may shorten this period under appropriate circumstances.

§ 711.8 Enforcement.

Except as provided in this section, NCUA administers and enforces the Interlocks Act with respect to federally insured credit unions, and may refer any case of a prohibited interlocking relationship involving these entities to the Attorney General of the United States to enforce compliance with the Interlocks Act and this part.

Part 712

Credit Union Service Organizations (CUSOs)

§ 712.1 What does this part cover?

This part establishes when a Federal credit union (FCU) can invest in and make loans to CUSOs. CUSOs are subject to review by NCUA. This part does not apply to corporate credit unions that have CUSOs subject to § 704.11 of this title. This part does not apply to state-chartered credit unions or the subsidiaries of state-chartered credit unions that do not have FCU investments or loans.

§ 712.2 How much can an FCU invest in or loan to CUSOs, and what parties may participate?

(a) *Investments.* An FCU's total investments in CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report.

(b) *Loans.* An FCU's total loans to CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. Loan authority is independent and separate from the 1% investment authority of subsection (a) of this section.

(c) *Parties.* An FCU may invest in or loan to a CUSO by itself, or with non-credit union parties.

(d) *Measurement for calculating regulatory limitation.* For purposes of paragraphs (a) and (b) of this section:

(1) *Paid-in and unimpaired capital and surplus* means shares plus post-closing, undivided earnings (this does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer); and

(2) Total investments in and total loans to CUSOs will be measured consistent with GAAP.

(e) *Divestiture.* If the limitations in paragraph (a) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method, without an additional cash outlay by the FCU, divestiture is not required. An FCU may continue to invest up to 1% without regard to the increase in the GAAP valuation resulting from a CUSO's profitability.

§ 712.3 What are the characteristics of and what requirements apply to CUSOs?

(a) *Structure.* An FCU can invest in a CUSO only if the CUSO is structured as a corporation, limited liability company, or limited partnership. An FCU may only participate in a limited partnership as a limited partner. For purposes of this part, "corporation" means a legally incorporated corporation as established and maintained under relevant federal or state law. For purposes of this part, "limited partnership" means a legally established limited partnership as established and maintained under relevant state law. For purposes of this part, "limited liability company" means a legally established limited liability company as established and maintained under relevant state law, provided that the FCU obtains written legal advice that the limited liability company is a recognized legal entity under the applicable laws of the state of formation and that the limited liability company is established in a manner that will limit potential exposure of the FCU to no more than the amount of funds invested in, or loaned to, the CUSO.

(b) *Customer base.* An FCU can invest in or loan to a CUSO only if the CUSO primarily serves credit unions, its membership, or the membership of credit unions contracting with the CUSO.

(c) *Federal credit union accounting for financial reporting purposes.* An FCU must account for its investments in or loans to a CUSO in conformity with "generally accepted accounting principles" (GAAP).

(d) *CUSO accounting; audits and financial statements; NCUA access to information.* An FCU must obtain written agreements from a CUSO, prior to investing in or lending to the CUSO, that the CUSO will:

(1) Account for all its transactions in accordance with GAAP;

(2) Prepare quarterly financial statements and obtain an annual opinion audit, by a licensed Certified Public Accountant, on its financial statements in accordance with "generally accepted auditing standards" (GAAS); and

(3) Provide NCUA and its representatives with complete access to any books and records of the CUSO and the ability to review CUSO internal controls, as deemed necessary by NCUA in carrying out its responsibilities under the Act.

(e) *Other laws.* A CUSO must comply with applicable Federal, state and local laws.

§ 712.4 What must an FCU and a CUSO do to maintain separate corporate identities?

(a) *Corporate separateness.* An FCU and a CUSO must be operated in a manner that demonstrates to the public the separate corporate existence of the FCU and the CUSO. Good business practices dictate that each must operate so that:

(1) Its respective business transactions, accounts, and records are not intermingled;

(2) Each observes the formalities of its separate corporate procedures;

(3) Each is adequately financed as a separate unit in the light of normal obligations reasonably foreseeable in a business of its size and character;

(4) Each is held out to the public as a separate enterprise;

(5) The FCU does not dominate the CUSO to the extent that the CUSO is treated as a department of the FCU; and

(6) Unless the FCU has guaranteed a loan obtained by the CUSO, all borrowings by the CUSO indicate that the FCU is not liable.

(b) *Legal opinion.* Prior to an FCU investing in a CUSO, the FCU must obtain written legal advice as to whether the CUSO is established in a manner that will limit potential exposure of the FCU to no more than the loss of funds invested in, or lent to, the CUSO. In addition, if a CUSO in which an FCU has an investment plans to change its structure under § 712.3(a), an FCU must also obtain prior, written legal advice that the CUSO will remain established in a manner that will limit potential exposure of the FCU to no more than the loss of funds invested in, or loaned to, the CUSO. The legal advice must address factors that have led courts to "pierce the corporate veil" such as inadequate capitalization, lack of separate corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records. The legal advice may be provided by independent legal counsel of the investing FCU or the CUSO.

§ 712.5 What activities and services are preapproved for CUSOs?

NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit any CUSO activities or services, or refuse to permit any CUSO activities or services. Otherwise, an FCU may invest in, loan to, and/or contract with only those CUSOs that are sufficiently bonded or insured for their specific operations and engaged in the preapproved activities and services related to the routine daily operations of credit unions. The specific activities listed within each preapproved category are provided in this section as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

(a) *Checking and currency services:*

(1) Check cashing;

(2) Coin and currency services; and

(3) Money order, savings bonds, travelers checks, and purchase and sale of U.S. Mint commemorative coins services;

(b) *Clerical, professional and management services:*

(1) Accounting services;

(2) Courier services;

(3) Credit analysis;

(4) Facsimile transmissions and copying services;

(5) Internal audits for credit unions;

(6) Locator services;

(7) Management and personnel training and support;

(8) Marketing services;

(9) Research services; and

(10) Supervisory committee audits;

(c) Business loan origination;

(d) *Consumer mortgage loan origination;*

(e) *Electronic transaction services:*

(1) Automated teller machine (ATM) services;

(2) Credit card and debit card services;

(3) Data processing;

(4) Electronic fund transfer (EFT) services;

(5) Electronic income tax filing;

(6) Payment item processing;

(7) Wire transfer services; and

(8) Cyber financial services;

(f) *Financial counseling services:*

(1) Developing and administering Individual Retirement Accounts (IRA), Keogh, deferred compensation, and other personnel benefit plans;

(2) Estate planning;
(3) Financial planning and counseling;
(4) Income tax preparation;
(5) Investment counseling; and
(6) Retirement counseling;

(g) *Fixed asset services:*
(1) Management, development, sale, or lease of fixed assets; and
(2) Sale, lease, or servicing of computer hardware or software;

(h) *Insurance brokerage or agency:*
(1) Agency for sale of insurance;
(2) Provision of vehicle warranty programs; and
(3) Provision of group purchasing programs;

(i) *Leasing:*
(1) Personal property; and
(2) Real estate leasing of excess CUSO property;

(j) *Loan support services:*
(1) Debt collection services;
(2) Loan processing, servicing, and sales; and
(3) Sale of repossessed collateral;

(k) *Record retention, security and disaster recovery services:*
(1) Alarm-monitoring and other security services;
(2) Disaster recovery services;
(3) Microfilm, microfiche, optical and electronic imaging, CD–ROM data storage and retrieval services;
(4) Provision of forms and supplies; and
(5) Record retention and storage;

(l) *Securities brokerage services;*

(m) *Shared credit union branch (service center) operations;*

(n) *Student loan origination;*

(o) *Travel agency services;*

(p) *Trust and trust-related services:*
(1) Acting as administrator for prepaid legal service plans;
(2) Acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity; and
(3) Trust services.

(q) *Real estate brokerage services.*

(r) *CUSO investments in non-CUSO service providers:* In connection with providing a permissible service, a CUSO may invest in a non-CUSO service provider. The amount of the CUSO's investment is limited to the amount necessary to participate in the service provider, or a greater amount if necessary to receive a reduced price for goods or services.

§ 712.6 What activities and services are prohibited for CUSOs?

General. CUSOs must not acquire control of, either directly or indirectly, another depository financial institution, nor invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility or similar organization, corporation, or association.

§ 712.7 What must an FCU do to add activities or services that are not preapproved?

In order for an FCU to invest in and/or loan to a CUSO that offers an unpreapproved activity or service, the FCU must first receive NCUA Board approval. The request for NCUA Board approval of an unpreapproved activity or service must include a full explanation and complete documentation of the activity or service and how that activity or service is associated with routine credit union operations. The request must be submitted jointly to your Regional Office and to the Secretary of the Board. The request will be treated as a petition to amend § 712.5 and NCUA will request public comment or otherwise act on the petition within 60 days after receipt. Before you engage in the petition process, you should seek an advisory opinion from NCUA's Office of General Counsel as to whether a proposed activity is already covered by one of the authorized categories without filing a petition to amend the regulation.

§ 712.8 What transaction and compensation limits might apply to individuals related to both an FCU and a CUSO?

(a) *Officials and Senior Management Employees.* The officials, senior management employees, and their immediate family members of an FCU that has outstanding loans or investments in a CUSO must not receive any salary, commission, investment income, or other income or compensation from the CUSO either directly or indirectly, or from any person being served through the CUSO. This provision does not prohibit such FCU officials or senior management employees from assisting in the operation of a CUSO, provided the officials or senior management employees are not compensated by the CUSO. Further, the CUSO may reimburse the FCU for the services

provided by such FCU officials and senior management employees only if the account receivable of the FCU due from the CUSO is paid in full at least every 120 days. For purposes of this paragraph (a), "official" means affiliated credit union directors or committee members. For purposes of this paragraph (a), "senior management employee" means affiliated credit union chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g. Assistant President, Vice President, or Assistant Treasurer/Manager) and the chief financial officer (Comptroller). For purposes of this paragraph (a), "immediate family member" means a spouse or other family members living in the same household.

(b) *Employees.* The prohibition contained in paragraph (a) of this section also applies to FCU employees not otherwise covered if the employees are directly involved in dealing with the CUSO unless the FCU's board of directors determines that the FCU employees' positions do not present a conflict of interest.

(c) *Others.* All transactions with business associates or family members of FCU officials, senior management employees, and their immediate family members, not specifically prohibited by paragraphs (a) and (b) of this section must be conducted at arm's length and in the interest of the FCU.

§ 712.9 When must an FCU comply with this part?

(a) *Investments.* An FCU's investments in CUSOs in existence prior to April 1, 1998, must conform with this part not later than April 1, 2001, unless the Board grants prior approval to continue such investment for a stated period.

(b) *Loans.* An FCU's loans to CUSOs in existence prior to April 1, 1998, must conform with this part not later than April 1, 2001, unless:

(1) The Board grants prior approval to continue the FCU's loan for a stated period; or

(2) Under the terms of its loan agreement, the FCU cannot require accelerated repayment without breaching the agreement.

Part 713

Fidelity Bond and Insurance Coverage for Federal Credit Unions

§ 713.1 What is the scope of this section?

This section provides the requirements for fidelity bonds for Federal credit union employees and officials and for other insurance coverage for losses such as theft, holdup, vandalism, etc., caused by persons outside the credit union.

§ 713.2 What are the responsibilities of a credit union's board of directors under this section?

The board of directors of each Federal credit union must at least annually review its fidelity and other insurance coverage to ensure that it is adequate in relation to the potential risks facing the credit union and the minimum requirements set by the Board.

§ 713.3 What bond coverage must a credit union have?

At a minimum, your bond coverage must:

(a) Be purchased in an individual policy from a company holding a certificate of authority from the Secretary of the Treasury; and

(b) Include fidelity bonds that cover fraud and dishonesty by all employees, directors, officers, supervisory committee members, and credit committee members.

§ 713.4 What bond forms may be used?

(a) The following basic bonds may be used without prior NCUA Board approval:

Credit union form No.	Carrier
Credit Union Blanket Bond Standard Form 23 of the Surety Association of America (revised May 1950).	Various.
Extended Form 23	USFG.
100	CUMIS (only approved for corporate credit union use).
200	CUMIS.
300	CUMIS.
400	CUMIS.
AIG 23	National Union Fire Insurance Co. of Pitts., PA.
Reliance Preferred Form 23	Reliance Insurance Company.
Form 31	ITT Hartford.
Form 24 with Credit Union Endorsement.	Continental (only approved for corporate credit union use).
Form 40325	St. Paul Fire and Marine.
Form F2350	Fidelity & Deposit Co. Of Maryland.
Form 9993 (6/97)	Progressive Casualty Insurance Co.
Credit Union Blanket Bond (1/96).	Cooperativas de Seguros Multiples de Puerto Rico.

(b) To use any of the following, you need prior written approval from the Board:

(1) Any other basic bond form; or

(2) Any rider or endorsement that limits coverage of approved basic bond forms.

§ 713.5 What is the required minimum dollar amount of coverage?

(a) The minimum required amount of fidelity bond coverage for any single loss is computed based on a Federal credit union's total assets.

Assets	Minimum bond
$0 to $10,000	Coverage equal to the credit union's assets.
$10,001 to $1,000,000	$10,000 for each $100,000 or fraction thereof.
$1,000,001 to $50,000,000	$100,000 plus $50,000 for each million or fraction over $1,000,000.
$50,000,001 to $295,000,000	$2,550,000 plus $10,000 for each million or fraction thereof over $50,000,000.
Over $295,000,000	$5,000,000.

(b) This is the minimum coverage required, but a Federal credit union's board of directors should purchase additional coverage when circumstances, such as cash on hand or cash in transit, warrant.

(c) While the above is the required minimum amount of bond coverage, credit unions should maintain increased coverage equal to the greater

of either of the following amounts within thirty days of discovery of the need for such increase:

(1) The amount of the daily cash fund, i.e. daily cash plus anticipated daily money receipts on the credit union's premises, or

(2) The total amount of the credit union's money in transit in any one shipment.

(3) Increased coverage is not required pursuant to paragraph (c) of this section, however, when the credit union temporarily increased its cash fund because of unusual events which cannot reasonably be expected to recur.

(d) Any aggregate limit of liability provided for in a fidelity bond policy must be at least twice the single loss limit of liability. This requirement does not apply to optional insurance coverage.

(e) Any proposal to reduce your required bond coverage must be approved in writing by the NCUA Board at least twenty days in advance of the proposed effective date of the reduction.

§ 713.6 What is the permissible deductible?

(a)(1) The maximum amount of allowable deductible is computed based on a Federal credit union's asset size, as follows:

Assets	Maximum deductible
$0–$100,000	No deductibles allowed.
$100,001–$250,000	$1,000.
$250,001–$1,000,000	$2,000.
Over $1,000,001	$2,000 plus 1/1000 of total assets up to a maximum deductible of $200,000.

(2) The deductibles may apply to one or more insurance clauses in a policy. Any deductibles in excess of the above amounts must receive the prior written permission of the NCUA Board.

(b) A deductible may not exceed 10 percent of a credit union's Regular Reserve unless a separate Contingency Reserve is set up for the excess. In computing the maximum deductible, valuation accounts such as the allowance for loan losses cannot be considered.

§ 713.7 May the NCUA Board require a credit union to secure additional insurance coverage?

The NCUA Board may require additional coverage when the Board determines that a credit union's current coverage is inadequate. The credit union must purchase this additional coverage within 30 days.

Part 714

Leasing

§ 714.1 What does this part cover?

This part covers the standards and requirements that you, a federal credit union, must follow when engaged in the leasing of personal property.

§ 714.2 What are the permissible leasing arrangements?

(a) You may engage in direct leasing. In direct leasing, you purchase personal property from a vendor, becoming the owner of the property at the request of your member, and then lease the property to that member.

(b) You may engage in indirect leasing. In indirect leasing, a third party leases property to your member and you then purchase that lease from the third party for the purpose of leasing the property to your member. You do not have to purchase the leased property if you comply with the requirements of § 714.3.

(c) You may engage in open-end leasing. In an open-end lease, your member assumes the risk and responsibility for any difference in the estimated residual value and the actual value of the property at lease end.

(d) You may engage in closed-end leasing. In a closed-end lease, you assume the risk and responsibility for any difference in the estimated residual value and the actual value of the property at lease end. However, your member is always responsible for any excess wear and tear and excess mileage charges as established under the lease.

§ 714.3 Must you own the leased property in an indirect leasing arrangement?

You do not have to own the leased property in an indirect leasing arrangement if:

(a) You obtain a full assignment of the lease. A full assignment is the assignment of all the rights, interests, obligations, and title in a lease to you, that is, you become the owner of the lease;

(b) You are named as the sole lienholder of the leased property;

(c) You receive a security agreement, signed by the leasing company, granting you a sole lien in the leased property and the right to take possession and dispose of the leased property in the event of a default by the lessee, a default in the leasing company's obligations to you, or a material adverse change in the leasing company's financial condition; and

(d) You take all necessary steps to record and perfect your security interest in the leased property. Your state's Commercial Code may treat the automobiles as inventory, and require a filing with the Secretary of State.

§ 714.4 What are the lease requirements?

(a) Your lease must be a net lease. In a net lease, your member assumes all the burdens of ownership including maintenance and repair, licensing and registration, taxes, and insurance;

(b) Your lease must be a full payout lease. In a full payout lease, you must reasonably expect to recoup your entire investment in the leased property, plus the estimated cost of financing, from the lessee's payments and the estimated residual value of the leased property at the expiration of the lease term; and

(c) The amount of the estimated residual value you rely upon to satisfy the full payout lease requirement may not exceed 25% of the original cost of the leased property unless the amount above 25% is guaranteed. Estimated residual value is the projected value of the leased property at lease end. Estimated residual value must be reasonable in light of the nature of the leased property and all circumstances relevant to the leasing arrangement.

§ 714.5 What is required if you rely on an estimated residual value greater than 25% of the original cost of the leased property?

If the amount of the estimated residual value you rely upon to satisfy the full payout lease requirement of § 714.4(b) exceeds 25% of the original cost of the leased property, a financially capable party must guarantee the excess. The guarantor may be the manufacturer. The guarantor may also be an insurance company with an A.M. Best rating of at least a B+, or with at least the equivalent of an A.M. Best B+ rating from another major rating company. You must obtain or have on file financial documentation demonstrating that the guarantor has the resources to meet the guarantee.

§ 714.6 Are you required to retain salvage powers over the leased property?

You must retain salvage powers over the leased property. Salvage powers protect you from a loss and provide you with the power to take action if there is an unanticipated change in conditions that threatens your financial position by significantly increasing your exposure to risk. Salvage powers allow you:

(a) As the owner and lessor, to take reasonable and appropriate action to salvage or protect the value of the property or your interests arising under the lease; or

(b) As the assignee of a lease, to become the owner and lessor of the leased property pursuant to your contractual rights, or take any reasonable and appropriate action to salvage or protect the value of the property or your interests arising under the lease.

§ 714.7 What are the insurance requirements applicable to leasing?

(a) You must maintain a contingent liability insurance policy with an endorsement for leasing or be named as the co-insured if you do not own the leased property. Contingent liability insurance protects you should you be sued as the owner of the leased property. You must use an insurance company with a nationally recognized industry rating of at least a B+.

(b) Your member must carry the normal liability and property insurance on the leased property. You must be named as an additional insured on the liability insurance policy and as the loss payee on the property insurance policy.

§ 714.8 Are the early payment provisions, or interest rate provisions, applicable in leasing arrangements?

You are not subject to the early payment provisions set forth in § 701.21(c)(6) of this chapter. You are also not subject to the interest rate provisions in § 701.21(c)(7).

§ 714.9 Are indirect leasing arrangements subject to the purchase of eligible obligation limit set forth in § 701.23 of this chapter?

Your indirect leasing arrangements are not subject to the eligible obligation limit if they satisfy the provisions of § 701.23(b)(3)(iv) that require that you make the final underwriting decision and that the lease contract is assigned to you very soon after it is signed by the member and the dealer or leasing company.

§ 714.10 What other laws must you comply with when engaged in leasing?

You must comply with the Consumer Leasing Act, 15 U.S.C. 1667–67f, and its implementing regulation, Regulation M, 12 CFR part 213. You must comply with state laws on consumer leasing, but only to the extent that the state leasing laws are consistent with the Consumer Leasing Act, 15 U.S.C. 1667e, or provide the member with greater protections or benefits than the Consumer Leasing Act. You are also subject to the lending rules set forth in § 701.21 of this chapter, except as provided in § 714.8 and § 714.9 of this part. The lending rules in § 701.21 address the preemption of other state and federal laws that impact on credit transactions.

Part 715

Supervisory Committee Audits and Verifications

§ 715.1 Scope of this part.

This part implements section 202(a)(6)(D) of the Federal Credit Union Act, 12 U.S.C. 1782(a)(6)(D), as added by section 201(a) of the Credit Union Membership Access Act, Pub. L. No. 105–219, 112 Stat. 918 (1998). This part prescribes the responsibilities of the Supervisory Committee to obtain an annual audit of the credit union according to its charter type and asset size, and to conduct a verification of members' accounts.

§ 715.2 Definitions used in this part.

As used in this part:

(a) *Balance sheet audit* refers to the examination of a credit union's assets, liabilities, and equity under generally accepted auditing standards (GAAS) by an independent public accountant for the purpose of opining on the fairness of the presentation on the balance sheet. Credit unions required to file call reports consistent with GAAP should ensure the audited balance sheet is likewise prepared on a GAAP basis. The opinion under this type of engagement would not address the fairness of the presentation of the credit union's income statement, statement of changes in equity (including comprehensive income), or statement of cash flows.

(b) *Compensated person* refers to any accounting/auditing professional, excluding a credit union employee, who is compensated for performing more than one supervisory committee audit and/or verification of members' accounts per calendar year.

(c) *Financial statements* refers to a presentation of financial data, including accompanying notes, derived from accounting records of the credit union, and intended to disclose a credit union's economic resources or obligations at a point in time, or the changes therein for a period of time, in conformity with GAAP, as defined herein, or regulatory accounting procedures. Each of the following is considered to be a financial statement: a balance sheet or statement of financial condition; statement of income or statement of operations; statement of undivided earnings; statement of cash flows; statement of changes in members' equity; statement of revenue and expenses; and statement of cash receipts and disbursements.

(d) *Financial statement audit* (also known as an "opinion audit") refers to an audit of the financial statements of a credit union performed in accordance with GAAS by an independent person who is licensed by the appropriate State or jurisdiction. The objective of a financial statement audit is to express an opinion as to whether those financial statements of the credit union present fairly, in all material respects, the financial position and the results of its operations and its cash flows in conformity with GAAP, as defined herein, or regulatory accounting practices.

(e) *GAAP* is an acronym for "generally accepted accounting principles" which refers to the conventions, rules, and procedures which define accepted accounting practice. GAAP includes both broad general guidelines and detailed practices and procedures, provides a standard by which to measure financial statement presentations, and encompasses not only accounting principles and practices but also the methods of applying them.

(f) *GAAS* is an acronym for "generally accepted auditing standards" which refers to the standards approved and adopted by the American Institute of Certified Public Accountants which apply when an "independent, licensed certified public accountant" audits financial statements. Auditing standards differ from auditing procedures in that "procedures" address acts to be performed, whereas "standards" measure the quality of the performance of those acts and the objectives to be achieved by use of the procedures undertaken. In addition, auditing standards address the auditor's professional qualifications as well as the judgment exercised in performing the audit and in preparing the report of the audit.

(g) *Independent* means the impartiality necessary for the dependability of the compensated auditor's findings. Independence requires the exercise of fairness toward credit union officials, members, creditors and others who may rely upon the report of a supervisory committee audit report.

(h) *Internal control* refers to the process, established by the credit union's board of directors, offi-

cers and employees, designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use, or disposition. A credit union's internal control structure consists of five components: control environment; risk assessment; control activities; information and communication; and monitoring. Reliable financial reporting refers to preparation of Call Reports (NCUA Forms 5300 and 5310) that meet management's financial reporting objectives. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition refers to prevention or timely detection of transactions involving such unauthorized access, use, or disposition of assets which could result in a loss that is material to the financial statements.

(i) *Reportable conditions* refers to a matter coming to the attention of the independent, compensated auditor which, in his or her judgment, represents a significant deficiency in the design or operation of the internal control structure of the credit union, which could adversely affect its ability to record, process, summarize, and report financial data consistent with the representations of management in the financial statements.

(j) *Report on Examination of Internal Control over Call Reporting* refers to an engagement in which an independent, licensed, certified public accountant or public accountant, consistent with attestation standards, examines and reports on management's written assertions concerning the effectiveness of its internal control over financial reporting in its most recently filed semiannual or year-end Call Report, with a concentration in high risk areas. For credit unions, such high risk areas most often include: lending activity; investing activity; and cash handling and deposit-taking activity.

(k) *State-licensed person* refers to a certified public accountant or public accountant who is licensed by the State or jurisdiction where the credit union is principally located to perform accounting or auditing services for that credit union.

(l) *Supervisory committee* refers to a supervisory committee as defined in Section 111(b) of the Federal Credit Union Act, 12 U.S.C. 1761(b). For some federally-insured state chartered credit unions, the "audit committee" designated by state statute or regulation is the equivalent of a supervisory committee.

(m) *Supervisory committee audit* refers to an engagement under either § 715.5 or § 715.6 of this part.

(n) *Working papers* refers to the principal record, in any form, of the work performed by the auditor and/or supervisory committee to support its findings and/or conclusions concerning significant matters. Examples include the written record of procedures applied, tests performed, information obtained, and pertinent conclusions reached in the engagement, proprietary audit programs, analyses, memoranda, letters of confirmation and representation, abstracts of credit union documents, reviewer's notes, if retained, and schedules or commentaries prepared or obtained in the course of the engagement.

§ 715.3 General responsibilities of the Supervisory Committee.

(a) *Basic.* The supervisory committee is responsible for ensuring that the board of directors and management of the credit union—

(1) Meet required financial reporting objectives;

(2) And establish practices and procedures sufficient to safeguard members' assets.

(b) *Specific.* To carry out the responsibilities set forth in paragraph (a) of this section, the supervisory committee must determine whether:

(1) Internal controls are established and effectively maintained to achieve the credit union's financial reporting objectives which must be sufficient to satisfy the requirements of the supervisory committee audit, verification of members' accounts and its additional responsibilities;

(2) The credit union's accounting records and financial reports are promptly prepared and accurately reflect operations and results;

(3) The relevant plans, policies, and control procedures established by the board of directors are properly administered; and

(4) Policies and control procedures are sufficient to safeguard against error, conflict of interest, self-dealing and fraud.

(c) *Mandates.* In carrying out the responsibilities set forth in paragraphs (a) and (b) of this section, the Supervisory Committee must:

(1) Ensure that the credit union adheres to the measurement and filing requirements for reports filed with the NCUA Board under § 741.6 of this chapter;

(2) Perform or obtain a supervisory committee audit, as prescribed in § 715.4 of this part;

(3) Verify or cause the verification of members' passbooks and accounts against the records of the credit union, as prescribed in § 715.8 of this part;

(4) Act to avoid imposition of sanctions for failure to comply with the requirements of this part, as prescribed in § 715.11 and § 715.12 of this part.

§ 715.4 Audit responsibility of the Supervisory Committee.

(a) *Annual audit requirement.* A federally-insured credit union is required to obtain an annual supervisory committee audit which occurs at least once every calendar year (period of performance) and must cover the period elapsed since the last audit period (period effectively covered).

(b) *Financial statement audit option.* Any federally-insured credit union, whether Federally- or State-chartered and regardless of asset size, may choose to fulfill its Supervisory Committee audit responsibility by obtaining an annual audit of its financial statements performed in accordance with GAAS by an independent person who is licensed to do so by the State or jurisdiction in which the credit union is principally located. (A "financial statement audit" is distinct from a "supervisory committee audit," although a financial statement audit is included among the options for fulfilling the supervisory committee audit requirement. *Compare* § 715.2(c) and (j).)

(c) *Other audit options.* A federally insured credit union which does not choose to obtain a financial statement audit as permitted by subsection (b) must fulfill its supervisory audit responsibility under either of § 715.5 or § 715.6 of this part, whichever is applicable. *See* Table 1. For purposes of this part, a credit union's asset size is the amount of total assets reported in the year-end Call Report (NCUA form 5300) filed for the calendar year-end immediately preceding the period under audit.

Type of Charter	*Asset Size*	*Minimum Audit Required to Fulfill Supervisory Audit Responsibility* [1]	*Part 715 section*
Federal charter	$500 Million or more	Financial statement audit per GAAS by independent, State-licensed person	§ 715.5
	Less than $500 Million but greater than $10 Million	Either financial statement audit or other supervisory committee audit options	
	$10 Million or less	Either of three supervisory committee audit options	
State charter	$500 Million or more	Financial statement audit per GAAS by independent, State-licensed person	§ 715.6
	Less than $500 Million	Either of three supervisory committee audit options unless audit prescribed by State law is more stringent	

[1] The Supervisory Committee audit responsibility under Part 715 can always be fulfilled by obtaining a financial statement audit. § 715.4(b).

§ 715.5 Audit of Federal Credit Unions.

(a) *Total assets of $500 million or greater.* To fulfill its Supervisory Committee audit responsibility, a federal credit union having total assets of $500 million or greater must obtain an annual audit of its financial statements performed in accordance with GAAS by an independent person who is licensed to do so by the State or jurisdiction in which the credit union is principally located.

(b) *Total assets of less than $500 million but more than $10 million.* To fulfill its Supervisory Committee audit responsibility, a Federally-chartered credit union having total assets of less than $500 million but more than $10 Million which does not choose to obtain an audit under § 715.5(a), must obtain an annual supervisory committee audit as prescribed in § 715.7.

(c) *Total assets of $10 million or less.* To fulfill its Supervisory Committee audit responsibility, a Federally-chartered credit union having total assets of $10 million or less must obtain an annual Supervisory Committee audit as prescribed in § 715.7.

(d) *Other requirements.* A federally chartered credit union, regardless of which audit it is required to obtain under this section, must meet other applicable requirements of this part.

§ 715.6 Audit of Federally-insured State-chartered credit unions.

(a) *Total assets of $500 million or greater.* To fulfill its Supervisory Committee audit responsibility, a federally-insured State-chartered credit union having total assets of $500 million or greater must obtain an annual audit of its financial statements performed in accordance with GAAS by an independent person who is licensed to do so by the State or jurisdiction in which the credit union is principally located.

(b) *Total assets of less than $500 million.* To fulfill its Supervisory Committee audit responsibility, a federally-insured State-chartered credit union having total assets of less than $500 million must obtain either an annual supervisory committee audit as prescribed under either § 715.6(a) or § 715.7, or an audit as prescribed by the State or jurisdiction in which the credit union is principally located, whichever audit is more stringent.

(c) *Other requirements.* A federally-insured, state-chartered credit union, regardless of which audit it is required to obtain under this section, must meet other applicable requirements of this part except §§ 715.5 and 715.12.

§ 715.7 Supervisory Committee audit alternatives to a financial statement audit.

A credit union which is not required to obtain a financial statement audit may fulfill its supervisory committee responsibility by any one of the following engagements:

(a) *Balance sheet audit.* A balance sheet audit, as defined in § 715.2(a), performed by a person who is licensed to do so by the State or jurisdiction in which the credit union is principally located; or

(b) *Report on Examination of Internal Control over Call Reporting.* An engagement and report on management's written assertions concerning the effectiveness of internal control over financial reporting in the credit union's most recently filed semiannual or year-end call report (NCUA Form 5300), as defined in § 715.2(j), performed by a person who is licensed to do so by the State or jurisdiction in which the credit union is principally located, and in which management specifies the criteria on which it based its evaluation of internal control; or

(c) *Audit per Supervisory Committee Guide.* An audit performed by the supervisory committee, its internal auditor, or any other qualified person (such as a certified public accountant, public accountant, league auditor, credit union auditor consultant, retired financial institutions examiner, etc.) in accordance with the procedures prescribed in NCUA's *Supervisory Committee Guide.* Qualified persons who are not State-licensed cannot provide assurance services under this subsection.

§ 715.8 Requirements for verification of accounts and passbooks.

(a) *Verification obligation.* The Supervisory Committee shall, at least once every two years, cause the passbooks (including any book, statements of account, or other record approved by the NCUA Board) and accounts of the members to be verified against the records of the treasurer of the credit union.

(b) *Methods.* Any of the following methods may be used to verify members' passbooks and accounts, as appropriate:

(1) *Controlled verification.* A controlled verification of 100 percent of members' share and loan accounts;

(2) *Statistical method.* A sampling method which provides for:

(i) Random selection:

(ii) A sample which is representative of the population from which it was selected;

(iii) An equal chance of selecting each dollar in the population;

(iv) Sufficient accounts in both number and scope on which to base conclusions concerning management's financial reporting objectives; and

(v) Additional procedures to be performed if evidence provided by confirmations alone is not sufficient.

(3) *Non-statistical method.* When the verification is performed by an Independent person licensed by the State or jurisdiction in which the credit union is principally located, the auditor may choose among the sampling methods set forth in paragraphs (b)(1) and (2) of this section and non-statistical sampling methods consistent with GAAS if such methods provide for:

(i) Sufficient accounts in both number and scope on which to base conclusions concerning management's financial reporting objectives to provide assurance that the General Ledger accounts are fairly stated in relation to the financial statements taken as a whole;

(ii) Additional procedures to be performed by the auditor if evidence provided by confirmations alone is not sufficient; and

(iii) Documentation of the sampling procedures used and of their consistency with GAAS (to be provided to the NCUA Board upon request).

(c) *Retention of records.* The supervisory committee must retain the records of each verification of members' passbooks and accounts until it completes the next verification of members' passbooks and accounts.

§ 715.9 Assistance from outside, compensated person.

(a) *Unrelated to officials.* A compensated auditor who performs a Supervisory Committee audit on behalf of a credit union shall not be related by blood or marriage to any management employee, member of either the board of directors, the Supervisory Committee or the credit committee, or loan officer of that credit union.

(b) *Engagement letter.* The engagement of a compensated auditor to perform all or a portion of the scope of a financial statement audit or supervisory committee audit shall be evidenced by an engagement letter. In all cases, the engagement must be contracted directly with the Supervisory Committee. The engagement letter must be signed by the compensated auditor and acknowledged therein by the Supervisory Committee prior to commencement of the engagement.

(c) *Contents of letter.* The engagement letter shall:

(1) Specify the terms, conditions, and objectives of the engagement;

(2) Identify the basis of accounting to be used;

(3) If a Supervisory Committee Guide audit, include an appendix setting forth the procedures to be performed;

(4) Specify the rate of, or total, compensation to be paid for the audit;

(5) Provide that the auditor shall, upon completion of the engagement, deliver to the Supervisory Committee a written report of the audit and notice in writing, either within the report or communicated separately, of any internal control reportable conditions and/or irregularities or illegal acts, if any, which come to the auditor's attention during the normal course of the audit (i.e., no notice required if none noted);

(6) Specify a target date of delivery of the written reports, such target date not to exceed 120 days from date of calendar or fiscal year-end under audit (period covered), unless the supervisory committee obtains a waiver from the supervising NCUA Regional Director;

(7) Certify that NCUA staff and/or the State credit union supervisor, or designated representatives of each, will be provided unconditional access to the complete set of original working papers, either at the offices of the credit union or at a mutually agreed upon location, for purposes of inspection; and

(8) Acknowledge that working papers shall be retained for a minimum of three years from the date of the written audit report.

(d) *Complete scope.* If the engagement is to perform a *Supervisory Committee Guide* audit intended to fully meet the requirements of § 715.7(c), the engagement letter shall certify that the audit will address the complete scope of that engagement;

(e) *Exclusions from scope.* If the engagement is to perform a *Supervisory Committee Guide* audit which will exclude any item required by the applicable section, the engagement letter shall:

(1) Identify the excluded items;

(2) State that, because of the exclusion(s), the resulting audit will not, by itself, fulfill the scope of a supervisory committee audit; and

(3) Caution that the supervisory committee will remain responsible for fulfilling the scope of

a supervisory committee audit with respect to the excluded items.

§ 715.10 Audit report and working paper maintenance and access.

(a) *Audit report.* Upon completion and/or receipt of the written report of a financial statement audit or a supervisory committee audit, the Supervisory Committee must verify that the audit was performed and reported in accordance with the terms of the engagement letter prescribed herein. The Supervisory Committee must submit the report(s) to the board of directors, and provide a summary of the results of the audit to the members of the credit union orally or in writing at the next annual meeting of the credit union. If a member so requests, the Supervisory Committee shall provide the member access to the full audit report. If the National Credit Union Administration ("NCUA") so requests, the Supervisory Committee shall provide NCUA a copy of each of the audit reports it receives or produces.

(b) *Working papers.* The supervisory committee shall be responsible for preparing and maintaining, or making available, a complete set of original working papers supporting each supervisory committee audit. The supervisory committee shall, upon request, provide NCUA staff unconditional access to such working papers, either at the offices of the credit union or at a mutually agreeable location, for purposes of inspecting such working papers.

§ 715.11 Sanctions for failure to comply with this part.

(a) *Sanctions.* Failure of a supervisory committee and/or its independent compensated auditor or other person to comply with the requirements of this section, or the terms of an engagement letter required by this section, is grounds for:

(1) The regional director to reject the supervisory committee audit and provide a reasonable opportunity to correct deficiencies;

(2) The regional director to impose the remedies available in § 715.12, provided any of the conditions specified therein is present; and

(3) The NCUA Board to seek formal administrative sanctions against the supervisory committee and/or its independent, compensated auditor pursuant to section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(b) *State Charters.* In the case of a federally-insured state chartered credit union, NCUA shall provide the state regulator an opportunity to timely impose a remedy satisfactory to NCUA before exercising it authority under § 741.202 of this chapter to impose a sanction permitted under paragraph (a) of this section.

§ 715.12 Statutory audit remedies for Federal credit unions.

(a) *Audit by alternative licensed person.* The NCUA Board may compel a federal credit union to obtain a supervisory committee audit which meets the minimum requirements of § 715.5 or § 715.7, and which is performed by an independent person who is licensed by the State or jurisdiction in which the credit union is principally located, for any fiscal year in which any of the following three conditions is present:

(1) The Supervisory Committee has not obtained an annual financial statement audit or performed a supervisory committee audit; or

(2) The Supervisory Committee has obtained a financial statement audit or performed a supervisory committee audit which does not meet the requirements of part 715 including those in § 715.8.

(3) The credit union has experienced serious and persistent recordkeeping deficiencies as defined in paragraph (c) of this section.

(b) *Financial statement audit required.* The NCUA Board may compel a federal credit union to obtain a financial statement audit performed in accordance with GAAS by an independent person who is licensed by the State or jurisdiction in which the credit union is principally located (even if such audit is not required by § 715.5), for any fiscal year in which the credit union has experienced serious and persistent recordkeeping deficiencies as defined in paragraph (c) of this section. The objective of a financial statement audit performed under this paragraph is to reconstruct the records of the credit union sufficient to allow an unqualified or, if necessary, a qualified opinion on the credit union's financial statements. An adverse opinion or disclaimer of opinion should be the exception rather than the norm.

(c) "*Serious and persistent recordkeeping deficiencies.*" A record-keeping deficiency is "serious" if the NCUA Board reasonably believes that the board of directors and management of the credit union have not timely met financial reporting objectives and established practices and procedures sufficient to safeguard members' assets. A serious recordkeeping deficiency is "persistent" when it continues beyond a usual, expected or reasonable period of time.

Part 716

Privacy of Consumer Financial Information and Appendix

§ 716.1 Purpose and scope.

(a) *Purpose.* This part governs the treatment of nonpublic personal information about consumers by the credit unions listed in paragraph (b) of this section. This part:

(1) Requires a credit union to provide notice to members about its privacy policies and practices;

(2) Describes the conditions under which a credit union may disclose nonpublic personal information about consumers to nonaffiliated third parties; and

(3) Provides a method for consumers to prevent a credit union from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to the exceptions in §§ 716.13, 716.14, and 716.15.

(b) *Scope.* (1) This part applies only to nonpublic personal information about individuals who obtain financial products or services for personal, family or household purposes. This part does not apply to information about companies or about individuals who obtain financial products or services for business, commercial or agricultural purposes. This part applies to federally-insured credit unions. This part refers to a federally-insured credit union as "you" or "the credit union."

(2) Nothing in this part modifies, limits, or supersedes the standards governing individually identifiable financial information promulgated by the Secretary of Health and Human Services under the authority of §§ 262 and 264 of the Health Insurance Portability and Accountability Act of 1996 (42 U.S.C. 1320d–1320d–8).

§ 716.2 Rule of construction.

The examples in this part and the sample clauses in appendix A of this part are not exclusive. Compliance with an example or use of a sample clause, to the extent applicable, constitutes compliance with this part.

§ 716.3 Definitions.

As used in this part, unless the context requires otherwise:

(a)(1) *Affiliate* means any company that controls, is controlled by, or is under common control with another company.

(2) *Examples.* (i) An affiliate of a federal credit union is a credit union service organization (CUSO), as provided in 12 CFR part 712, that is controlled by the federal credit union.

(ii) An affiliate of a federally-insured, state-chartered credit union is a company that is controlled by the credit union.

(b)(1) *Clear and conspicuous* means that a notice is reasonably understandable and designed to call attention to the nature and significance of the information in the notice.

(2) *Examples.* (i) *Reasonably understandable.* You make your notice reasonably understandable if you:

(A) Present the information contained in the notice in clear, concise sentences, paragraphs and sections;

(B) Use short, explanatory sentences or bullet lists whenever possible;

(C) Use definite, concrete, everyday words and active voice whenever possible;

(D) Avoid multiple negatives;

(E) Avoid legal and highly technical business terminology wherever possible; and

(F) Avoid explanations that are imprecise and readily subject to different interpretations.

(ii) *Designed to call attention.* You design your notice to call attention to the nature and significance of the information in it if you:

(A) Use a plain-language heading to call attention to the notice;

(B) Use a typeface and type size that are easy to read;

(C) Provide wide margins and ample line spacing;

(D) Use boldface or italics for key words; and

(E) In a form that combines your notice with other information, use distinctive type size, style, and graphic devices, such as shading or sidebars.

(iii) *Notices on web sites.* If you provide notices on a web page, you design your notice to

call attention to the nature and significance of the information in it if you use text or visual cues to encourage scrolling down the page if necessary to view the entire notice and ensure that other elements on the web site (such as text graphics, hyperlinks or sound) do not distract attention form the notice, and you either:

(A) Place the notice on a screen frequently accessed by consumers, such as a home page or a page on which transactions are conducted; or

(B) Place a link on a screen frequently accessed by consumers, such as a home page or a page on which transactions are conducted, that connects directly to the notice and is labeled appropriately to convey the importance, nature and relevance of the notice.

(c) *Collect* means to obtain information that you organize or can retrieve by the name of an individual or by identifying number, symbol, or other identifying particular assigned to the individual, irrespective of the source of the underlying information.

(d) *Company* means any corporation, limited liability company, business trust, general or limited partnership, association or similar organization.

(e)(1) *Consumer* means an individual who obtains or has obtained a financial product or service from you, that is to be used primarily for personal, family or household purposes, or that individual's legal representative.

(2) *Examples.* (i) An individual who provides nonpublic personal information to you in connection with obtaining or seeking to obtain credit union membership is your consumer regardless of whether you establish a member relationship.

(ii) An individual who provides nonpublic personal information to you in connection with using your ATM is your consumer.

(iii) If you hold ownership or servicing rights to an individual's loan, the individual is your consumer, even if you hold those rights in conjunction with one or more financial institutions. (The individual is also a consumer with respect to the other financial institutions involved). This applies, even if you, or another financial institution with those rights, hire an agent to collect on the loan or to provide processing or other services.

(iv) An individual who is a consumer of another financial institution is not your consumer solely because you act as agent for, or provide processing or other services to, that financial institution.

(v) An individual is not your consumer solely because he or she is a participant or a beneficiary of an employee benefit plan that you sponsor or for which you act as a trustee or fiduciary.

(f) *Consumer reporting agency* has the same meaning as in section 603(f) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f)).

(g) *Control* of a company means:

(1) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting security of the company, directly or indirectly, or acting through one or more other persons;

(2) Control in any manner over the election of a majority of the directors, trustees or general partners (or individuals exercising similar functions) of the company; or

(3) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the company, as the NCUA determines. With respect to state-chartered credit unions, NCUA will consult with the appropriate state regulator prior to making its determination.

(4) *Example.* NCUA will presume a credit union has a controlling influence over the management or policies of a CUSO, if the CUSO is 67% owned by credit unions.

(h) *Credit union* means a federal or state-chartered credit union that the National Credit Union Share Insurance Fund insures.

(i) *Customer* means a consumer who has a customer relationship with a financial institution other than a credit union.

(j) *Customer relationship* means a continuing relationship between a consumer and a financial institution other than a credit union.

(k) *Federal functional regulator* means—

(1) The National Credit Union Administration Board;

(2) The Board of Governors of the Federal Reserve System;

(3) The Office of the Comptroller of the Currency;

(4) The Board of Directors of the Federal Deposit Insurance Corporation;

(5) The Director of the Office of Thrift Supervision; and

(6) The Securities and Exchange Commission.

(l)(1) *Financial institution* means any institution the business of which is engaging in activities that are financial in nature or incidental to such finan-

cial activity as described in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

(2) Examples of financial institutions may include, but are not limited to: credit unions; banks; insurance companies; securities brokers, dealers, and underwriters; loan brokers and servicers; tax planners and preparation services; personal property appraisers; real estate appraisers; career counselors for employees in financial occupations; digital signature services; courier services; real estate settlement services; manufacturers of computer software and hardware; and travel agencies operated in connection with financial services.

(3) *Financial institution* does not include:

(i) Any person or entity with respect to any financial activity that is subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*);

(ii) The Federal Agricultural Mortgage Corporation or any entity chartered and operating under the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*); or

(iii) Institutions chartered by Congress specifically to engage in securitizations, secondary market sales (including sales of servicing rights) or similar transactions related to a transaction of a consumer, as long as such institutions do not sell or transfer nonpublic personal information to a nonaffiliated third party.

(m)(1) *Financial product or service* means any product or service that a financial holding company could offer by engaging in an activity that is financial in nature or incidental to such a financial activity under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

(2) *Financial service* includes your evaluation or brokerage of information that you collect in connection with a request or an application from a consumer for a financial product or service.

(n) *Member* means a consumer who has a member relationship with you. For purposes of this part only, it will include certain nonmembers.

(o)(1) *Member relationship* means a continuing relationship between a consumer and you under which you provide one or more financial products or services to the consumer that are to be used primarily for personal, family or household purposes. As noted in the examples, this will include certain consumers that are not your members.

(2) *Examples.* (i) A consumer has a continuing relationship with you if the consumer:

(A) Is your member as defined in your bylaws;

(B) Is a nonmember who has a share, share draft, or credit card account with you jointly with a member;

(C) Is a nonmember who has a loan that you service;

(D) Is a nonmember who has an account with you and you are a credit union that has been designated as a low-income credit union; or

(E) Is a nonmember who has an account in a federally-insured, state-chartered credit union pursuant to state law.

(ii) A consumer does not, however, have a member relationship with you if the consumer is a nonmember and:

(A) The consumer only obtains a financial product or service in isolated transactions, such as using your ATM to withdraw cash from an account maintained at another financial institution or purchasing travelers checks; or

(B) You sell the consumer's loan and do not retain the rights to service that loan. (p)(1) *Nonaffiliated third party* means any person except:

(i) Your affiliate; or

(ii) A person employed jointly by you and any company that is not your affiliate (but nonaffiliated third party includes the other company that jointly employs the person).

(q)(1) *Nonpublic personal information* means:

(i) Personally identifiable financial information; and

(ii) Any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information.

(2) *Nonpublic personal information* does not include:

(i) Publicly available information, except as included on a list described in paragraph (q)(1)(ii) of this section; or

(ii) Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived without using any personally identifiable financial information, other than publicly available information.

(3) *Examples of lists.* (i) Nonpublic personal information includes any list of individuals' names and street addresses that is derived in whole or in part using personally identifiable financial information, other than publicly available information, such as account numbers.

(ii) Nonpublic personal information does not include any list of individuals' names and addresses that contains only publicly available information, is not derived using personally identifiable financial information, other than publicly available information, either in whole or in part, and is not disclosed in a manner that indicates that any of the individuals on the list is a consumer of a credit union, other than publicly available information.

(r)(1) *Personally identifiable financial information* means any information:

(i) A consumer provides to you to obtain a financial product or service from you;

(ii) About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or

(iii) You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer.

(2) Personally identifiable financial information does not include publicly available information.

(3) *Examples.* (i) *Information included.* Personally identifiable financial information includes:

(A) Information a consumer provides to you on an application to obtain membership, a loan, credit card or other financial product or service;

(B) Account balance information, payment history, overdraft history, and credit or debit card purchase information;

(C) The fact that an individual is or has been one of your members or has obtained a financial product or service from you;

(D) Any information about your consumer if it is disclosed in a manner that indicates that the individual is or has been your consumer;

(E) Any information that a consumer provides to you or that you or your agent otherwise obtain in connection with collecting on a loan or servicing a loan;

(F) Any information you collect through an Internet "cookie" (an information collecting device from a web server); and

(G) Information from a consumer report.

(ii) *Information not included.* Personally identifiable financial information does not include:

(A) A list of names and addresses of customers of an entity that is not a financial institution; and

(B) Information that does not identify a consumer, such as aggregate information or blind data that does not contain personal identifiers such as account numbers, names, or addresses.

(s)(1) *Publicly available information* means any information that you have a reasonable basis to believe is lawfully made available to the general public from:

(i) Federal, state or local government records;

(ii) Widely distributed media; or

(iii) Disclosures to the general public that are required to be made by federal, state or local law.

(2) *Reasonable basis.* You have a reasonable basis to believe that information is lawfully made available to the general public if you have taken steps to determine:

(i) That the information is of the type that is available to the general public; and

(ii) Whether an individual can direct that the information not be made available to the general public and, if so, that your member or consumer has not done so.

(3) *Examples.* (i) *Government records.* Publicly available information in government records includes information in government real estate records and security interest filings.

(ii) *Widely distributed media.* Publicly available information from widely distributed media includes information from a telephone book, a television or radio program, a newspaper or a web site that is available to the general public on an unrestricted basis. A web site is not restricted merely because an Internet service provider or site operator requires a fee or a password, so long as access is available to the general public.

(iii) *Reasonable basis.* (1) You have a reasonable basis to believe that mortgage information is lawfully made available to the general public if you have determined that the information is of the type included on the public record in the jurisdiction where the mortgage would be recorded.

(2) You have a reasonable basis to believe that an individual's telephone number is lawfully made available to the general public if you have located the telephone number in the telephone book or have been informed by the consumer that the telephone number is not unlisted.

(t) *You* means a federally-insured credit union.

Subpart A—Privacy and Opt Out Notices

§ 716.4 Initial privacy notice to consumers required.

(a) *Initial notice requirement.* You must provide a clear and conspicuous notice that accurately reflects your privacy policies and practices to a:

(1) *Member*, not later than when you establish a member relationship, except as provided in paragraph (e) of this section; and

(2) *Consumer*, before you disclose any nonpublic personal information about the consumer to any nonaffiliated third party, if you make such a disclosure other than as authorized by §§ 716.14 and 716.15.

(b) *When initial notice to a consumer is not required.* You are not required to provide an initial notice to a consumer under paragraph (a) of this section if:

(1) You do not disclose any nonpublic personal information about the consumer to any nonaffiliated third party, other than as authorized by §§ 716.14 and 716.15; and

(2) You do not have a member relationship with the consumer.

(c) *When you establish a member relationship.* (1) *General rule*. You establish a member relationship when you and the consumer enter into a continuing relationship.

(2) *Special rule for loans*. You establish a member relationship with a consumer when you originate, or acquire the servicing rights to a loan to the consumer for personal, household or family purposes and that is the only basis for the member relationship. If you subsequently transfer the servicing rights to that loan to another financial institution, the member relationship transfers with the servicing rights.

(3)(i) *Examples of establishing member relationship*. You establish a member relationship when the consumer:

(A) Becomes your member under your bylaws;

(B) Is a nonmember and opens a credit card account with you jointly with a member under your procedures;

(C) Is a nonmember and executes the contract to open a share or share draft account with you or obtains credit from you jointly with a member, including an individual acting as a guarantor;

(D) Is a nonmember and opens an account with you and you are a credit union designated as a low-income credit union;

(E) Is a nonmember and opens an account with you pursuant to state law and you are a state-chartered credit union.

(ii) *Examples of loan rule*. You establish a member relationship with a consumer who obtains a loan for personal, family, or household purposes when you:

(A) Originate the loan to the consumer and retain the servicing rights; or

(B) Purchase the servicing rights to the consumer's loan.

(d) *Existing members*. When an existing member obtains a new financial product or service that is to be used primarily for personal, family, or household purposes, you satisfy the initial notice requirements of paragraph (a) of this section as follows:

(1) You may provide a revised policy notice, under § 716.8, that covers the member's new financial product or service; or

(2) If the initial, revised, or annual notice that you most recently provided to that member was accurate with respect to the new financial product or service, you do not need to provide a new privacy notice under paragraph (a) of this section.

(e) *Exceptions to allow subsequent delivery of notice.* (1) You may provide the initial notice required by paragraph (a)(1) of this section within a reasonable time after you establish a member relationship if:

(i) Establishing the member relationship is not at the member's election;

(ii) Providing notice not later than when you establish a member relationship would substantially delay the member's transaction and the member agrees to receive the notice at a later time.

(2) *Examples of exceptions*. (i) *Not at member's election*. Establishing a member relationship is not at the member's election if you acquire a member's deposit liability from another financial institution and the member does not have a choice about your acquisition.

(ii) *Substantial delay of member's transaction*. Providing notice not later than when you establish a member relationship would substantially delay the member's transaction when:

(A) You and the individual agree over the telephone to enter into a member relationship involving prompt delivery of the financial product or service; or

(B) You establish a member relationship with an individual under a program authorized by Title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 *et seq.*) or similar student loan programs where loan proceeds are disbursed promptly without prior communication between you and the member.

(iii) *No substantial delay of member's transaction.* Providing notice not later than when you establish a member relationship would not substantially delay the member's transaction when the relationship is initiated in person at your office or through other means by which the member may view the notice, such as on a web site.

(f)(1) *Joint relationships.* If two or more consumers jointly obtain a financial product or service, other than a loan, from you, you may satisfy the requirements of paragraph (a) of this section by providing one initial notice to those consumers jointly.

(2) *Special rule for loans.* (i) You are required to provide an initial notice to a borrower or guarantor on a loan if you share his or her nonpublic personal information with nonaffiliated third parties other than for purposes under §§ 716.13, 716.14 and 716.15. (ii) You may satisfy the annual notice requirements of § 716.6 by providing one notice to those borrowers and guarantors jointly.

(g) *Delivery.* When you are required to deliver an initial privacy notice by this section, you must deliver it according to the methods in § 716.9. If you use a short-form initial notice for nonmember consumers according to § 716.6(c), you may deliver your privacy notice according to § 716.6(c)(3).

§ 716.5 Annual privacy notice to members required.

(a)(1) *General rule.* You must provide a clear and conspicuous notice to members that accurately reflects your privacy policies and practices not less than annually during the continuation of the member relationship. *Annually* means at least once in any period of 12 consecutive months during which that relationship exists. You may define the 12-consecutive-month period, but you must apply it to the member on a consistent basis.

(2) *Example.* You provide a notice annually if you define the 12-consecutive-month period as a calendar year and provide the annual notice to the member once in each calendar year following the calendar year in which you provide the initial notice. For example, if a member opens an account on any day of year one, you must provide an annual notice to that member by December 31 of year two.

(b) (1) *Termination of member relationship.* You are not required to provide an annual notice to a former member.

(2) *Examples.* Your member becomes your former member when:

(i) An individual is no longer your member as defined in your bylaws;

(ii) In the case of a nonmember's share or share draft account, the account is inactive under the credit union's policies;

(iii) In the case of a nonmember's closed-end loan, the loan is paid in full, you charge off the loan, or you sell the loan without retaining servicing rights;

(iv) In the case of a credit card relationship or other open-end credit relationship with a nonmember, you no longer provide any statements or notices to the nonmember concerning that relationship or you sell the credit card receivables without retaining servicing rights; or

(v) You have not communicated with the nonmember about the relationship for a period of twelve consecutive months, other than to provide annual privacy notices or promotional material.

(c) *Delivery.* When you are required to deliver an annual privacy notice by this section, you must deliver it according to the methods in § 716.9.

§ 716.6 Information to be included in initial and annual privacy notices.

(a) *General rule.* The initial and annual privacy notices under §§ 716.4 and 716.5 must include each of the following items of information that applies to you or to the consumers to whom you send your privacy notice, in addition to any other information you wish to provide:

(1) The categories of nonpublic personal information that you collect;

(2) The categories of nonpublic personal information that you disclose;

(3) The categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information, other than those parties to whom you disclose information under §§ 716.14 and 716.15;

(4) The categories of nonpublic personal information about your former members that

you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose it, other than those parties to whom you disclose information under §§ 716.14 and 716.15;

(5) If you disclose nonpublic personal information to a nonaffiliated third party under § 716.13 (and no other exception applies to that disclosure), a separate statement of the categories of information you disclose and the categories of third parties with whom you have contracted;

(6) An explanation of the consumer's right under § 716.10(a) to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including the methods by which the consumer may exercise that right at that time;

(7) Any disclosures that you make under section 603(d)(2)(A)(iii) of the Fair Credit Reporting Act (15 U.S.C. 1681a(d)(2)(A)(iii)) (that is, notices regarding the ability to opt out of disclosure of information among affiliates);

(8) Your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and

(9) Any disclosures you make under paragraph (b) of this section.

(b) *Description of nonaffiliated third parties subject to exceptions.* If you disclose nonpublic personal information to third parties as authorized under §§ 716.14 and 716.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 716.4 and 716.5. When describing the categories with respect to those parties, you are required to state only that you make disclosures to other nonaffiliated third parties as permitted by law.

(c) *Short-form initial notice with opt out notice for nonmember consumers.* (1) You may satisfy the initial notice requirements in §§ 716.4(a)(2), 716.7(b), and 716.7(c) for a consumer who is not a member by providing a short-form initial notice at the same time as you deliver an opt out notice as required in § 716.7.

(2) A short-form initial notice must:

(i) Be clear and conspicuous;

(ii) State that your privacy notice is available upon request; and

(iii) Explain a reasonable means by which the consumer may obtain that notice.

(3) You must deliver your short-form initial notice according to § 716.9. You are not required to deliver your privacy notice with your short form initial notice. You instead may simply provide the consumer a reasonable means to obtain your privacy notice. If a consumer who receives your short-form notice requests your privacy notice, you must deliver your privacy notice according to § 716.9.

(4) *Examples of obtaining privacy notice.* You provide a reasonable means by which a consumer may obtain a copy of your privacy notice if you:

(i) Provide a toll-free telephone number that the consumer may call to request the notice; or

(ii) For a consumer who conducts business in person at your office, maintain copies of the notice on hand that you provide to a consumer immediately upon request.

(d) *Future disclosures.* Your notice may include:

(1) Categories of nonpublic personal information that you reserve the right to disclose in the future, but do not currently disclose; and

(2) Categories of affiliates or nonaffiliated third parties to whom you reserve the right in the future to disclose, but to whom you do not currently disclose, nonpublic personal information.

(e) *Examples.* (1) *Categories of nonpublic personal information that you collect.*

You satisfy the requirement to categorize the nonpublic personal information that you collect if you list the following categories, as applicable:

(i) Information from the consumer;

(ii) Information about the consumer's transactions with you or your affiliates;

(iii) Information about the consumer's transactions with nonaffiliated third parties; and

(iv) Information from a consumer reporting agency.

(2) *Categories of nonpublic personal information you disclose.* (i) You satisfy the requirement to categorize the nonpublic personal information that you disclose if you list the categories described in paragraph (e)(1) of this section, as applicable, and a few examples to illustrate the types of information in each category.

(ii) If you reserve the right to disclose all of the nonpublic personal information about consumers that you collect, you may simply state that fact without describing the categories or examples of the nonpublic personal information you disclose.

(3) *Categories of affiliates and nonaffiliated third parties to whom you disclose.* You satisfy the requirement to categorize the affiliates and

nonaffiliated third parties to whom you disclose nonpublic personal information if you list the following categories, as applicable, and a few examples to illustrate the types of third parties in each category.

(i) Financial service providers;

(ii) Non-financial companies; and

(iii) Others.

(4) *Disclosures under exception for service providers and joint marketers.* If you disclose nonpublic personal information under the exception in § 716.13 to a nonaffiliated third party to market products or services that you offer alone or jointly with another financial institution, you satisfy the disclosure requirement of paragraph (a)(5) of this section if you:

(i) List the categories of nonpublic personal information you disclose, using the same categories and examples you used to meet the requirements of paragraphs (a)(2) of this section, as applicable; and

(ii) State whether the third party is:

(A) A service provider that performs marketing services on your behalf or on behalf of you and another financial institution; or

(B) A financial institution with whom you have a joint marketing agreement.

(5) *Simplified notices.* If you do not disclose, and do not intend to disclose, nonpublic personal information about members or former members to affiliates or nonaffiliated third parties except as authorized under §§ 716.14 and 716.15, you may simply state that fact, in addition to the information you must provide under paragraphs (a)(1), (a)(8), (a)(9) and (c) of this section.

(6) *Confidentiality and security.* You describe your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information if you do both of the following:

(i) Describe in general terms who is authorized to have access to the information.

(ii) State whether you have security practices and procedures in place to ensure the confidentiality of the information in accordance with your policy. You are not required to describe technical information about the safeguards you use.

(7) *Joint notice with affiliates.* You may provide a joint notice from you and one or more of your affiliates or other financial institutions, as specified in the notice, as long as the notice is accurate with respect to you and the other institution.

§ 716.7 Form of opt out notice to consumers and opt out methods.

(a)(1) *Form of opt out notice.* If you are required to provide an opt out notice under § 716.10(a)(1), you must provide a clear and conspicuous notice to each of your consumers that accurately explains the right to opt out under that section. The notice must state:

(i) That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;

(ii) That the consumer has the right to opt out of that disclosure; and

(iii) A reasonable means by which the consumer may exercise the opt out right.

(2) *Examples.* (i) *Adequate opt out notice.* You provide adequate notice that the consumer can opt out of the disclosure of nonpublic personal information to a nonaffiliated third party if you:

(A) Identify all of the categories of nonpublic personal information that you disclose or reserve the right to disclose and all of the categories of nonaffiliated third parties to whom you disclose the information, as described in § 716.6(a)(2) and (3) and state that the consumer can opt out of the disclosure of that information; and

(B) Identify the financial products or services that the consumer obtains from you, either singly or jointly, to which the opt out direction would apply.

(ii) *Reasonable opt out means.* You provide a reasonable means to exercise an opt out right if you:

(A) Designate check-off boxes in a prominent position on the relevant forms with the opt out notice;

(B) Include a reply form together with the opt out notice;

(C) Provide an electronic means to opt out, such as a form that can be sent via electronic mail or a process at your web site, if the consumer agrees to the electronic delivery of information; or

(D) Provide a toll-free telephone number that consumers may call to opt out.

(iii) *Unreasonable opt out means.* You *do not* provide a reasonable means of opting out if:

(A) The only means of opting out is for the consumer to write his or her own letter to exercise that opt out right; or

(B) The only means of opting out as described in any notice subsequent to the initial notice is to use a check-off box that was provided with the initial notice but not included with the subsequent notice.

(iv) *Specific opt out means.* You may require each consumer to opt out through a specific means, as long as that means is reasonable for that consumer.

(b) *Same form as initial notice permitted.* You may provide the opt out notice together with or on the same written or electronic form as the initial notice you provide in accordance with § 716.4.

(c) *Initial notice required when opt out notice delivered subsequent to initial notice.* If you provide the opt out notice later than required for the initial notice in accordance with § 716.4, you must also include a copy of the initial notice in writing or, if the consumer agrees, electronically.

(d) *Joint relationships.* (1) If two or more consumers jointly obtain a financial product or service, other than a loan, from you, you may provide only a single opt out notice. Your opt out notice must explain how you will treat an opt out direction by a joint consumer as explained in the examples in paragraph (d)(5) of this section.

(2) Any of the joint consumers may exercise the right to opt out. You may either:

(i) Treat an opt out direction by a joint consumer to apply to all of the associated joint consumers; or

(ii) Permit each joint consumer to opt out separately.

(3) If you permit each joint consumer to opt out separately, you must permit one of the joint consumers to opt out on behalf of all of the joint consumers.

(4) You may not require all joint consumers to opt out before you implement any opt out direction.

(5) *Example.* If John and Mary have a joint share account with you and arrange for you to send statements to John's address, you may do any of the following, but you must explain in your opt out notice which opt out policy you will follow:

(i) Send a single opt out notice to John's address, but you must accept an opt out direction from either John or Mary.

(ii) Treat an opt out direction by either John or Mary as applying to the entire account. If you do so, and John opts out, you may not require Mary to opt out as well before implementing John's opt out direction.

(iii) Permit John and Mary to make different opt out directions. If you do so, and if John and Mary both opt out, you must permit one or both of them to notify you in a single response (such as on a form or through a telephone call).

(6) *Special rule for loans.* (i) You are required to provide an initial opt out notice to a borrower or guarantor on a loan if you share his or her nonpublic personal information with nonaffiliated third parties other than for purposes under §§ 716.13, 716.14 and 716.15.

(ii) You may satisfy your annual opt out notice requirement by providing one notice to those borrowers and guarantors jointly.

(e) *Time to comply with opt out.* You must comply with the consumer's opt out direction as soon as reasonably practicable after you receive it.

(f) *Continuing right to opt out.* A consumer may exercise the right to opt out at any time.

(g) *Duration of consumer's opt out direction.* (1) A consumer's direction to opt out under this section is effective until the consumer revokes it in writing or, if the consumer agrees, electronically.

(2) When a member relationship terminates, the member's opt out direction continues to apply to the nonpublic personal information that you collected during or related to the relationship. If the individual subsequently establishes a new member relationship with you, the opt out direction that applied to the former relationship does not apply to the new relationship.

(h) *Delivery.* When you are required to deliver an opt out notice by this section, you must deliver it according to the methods in § 716.9.

§ 716.8 Revised privacy notices.

(a) *General rule.* Except as otherwise authorized in this part, you must not, directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party other than as described in the initial notice that you provided to that consumer under § 716.4, unless:

(1) You have provided to the consumer a revised notice that accurately describes your policies and practices;

(2) You have provided to the consumer a new opt out notice;

(3) You have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and

(4) The consumer does not opt out.

(b) *Examples.* (1) Except as otherwise permitted by §§ 716.13, 716.14 and 716.15, you must provide a revised notice if you—

(i) Disclose a new category of nonpublic personal information to any nonaffiliated third party;

(ii) Disclose nonpublic personal information to a new category of nonaffiliated third party; or

(iii) Disclose nonpublic personal information about a former member to a nonaffiliated third party, and that former member has not had the opportunity to exercise an opt out right regarding that disclosure.

(2) A revised notice is not required if you disclose nonpublic personal information to a new nonaffiliated third party that you adequately described in your prior notice.

(c) *Delivery.* When you are required to deliver a revised privacy notice by this section, you must deliver it according to the methods in § 716.9.

§ 716.9 Delivering privacy and opt out notices.

(a) *How to provide notices.* You must provide any privacy notices and opt out notices, including short-form initial notices, that this part requires so that each consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically.

(b) (1) *Examples of reasonable expectation of actual notice.* You may reasonably expect that a consumer will receive actual notice if you:

(i) Hand-deliver a printed copy of the notice to the consumer;

(ii) Mail a printed copy of the notice to the last known address of the consumer;

(iii) For the consumer who conducts transactions electronically, post the notice on the electronic site and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining a particular financial product or service;

(iv) For an isolated transaction with the consumer, such as an ATM transaction, post the notice on the ATM screen and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining the particular financial product or service.

(2) *Examples of unreasonable expectations of actual notice.* You may not, however, reasonably expect that a consumer will receive actual notice if you:

(i) Only post a sign in your branch or office or generally publish advertisements of your privacy policies and practices;

(ii) Send the notice via electronic mail to a consumer who does not obtain a financial product or service from you electronically.

(c) *Annual notices only.* You may reasonably expect that a member will receive actual notice of your annual privacy notice if:

(1) The member uses your web site to access financial products and services electronically and agrees to receive notices at your web site and you post your current privacy notice continuously in a clear and conspicuous manner on your web site; or

(2) The member has requested that you refrain from sending any information regarding the member relationship, and your current privacy notice remains available to the member upon request.

(d) *Oral description of notice insufficient.* You may not provide any notice required by this part solely by orally explaining the notice, either in person or over the telephone.

(e) *Retention or accessibility of notices for members.* (1) For members only, you must provide the initial notice required by § 716.4 (a)(1), the annual notice required by § 716.5(a) and the revised notice required by § 716.8 so that the member can retain them or obtain them later in writing or, if the member agrees, electronically.

(2) *Examples of retention or accessibility.* You provide the privacy notice to the member so that the member can retain it or obtain it later if you:

(i) Hand-deliver a printed copy of the notice to the member;

(ii) Mail a printed copy of the notice to the last known address of the member upon request of the member; or

(iii) Make your current privacy notice available on a web site (or a link to another web site) for the member who obtains a financial product or service electronically and agrees to receive the notice at the web site.

Subpart B—Limits on Disclosures

§ 716.10 Limits on disclosure of nonpublic personal information to nonaffiliated third parties.

(a)(1) *Conditions for disclosure.* Except as otherwise authorized in this part, you may not, directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party unless:

(i) You have provided to the consumer an initial notice as required under § 716.4;

(ii) You have provided to the consumer an opt out notice as required in § 716.7;

(iii) You have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and

(iv) The consumer does not opt out.

(2) *Opt out definition.* Opt out means a direction by the consumer that you not disclose nonpublic personal information about that consumer to a nonaffiliated third party, other than as permitted by §§ 716.13, 716.14 and 716.15.

(3) *Examples of reasonable opportunity to opt out.* You provide a consumer with a reasonable opportunity to opt out if:

(i) *By mail.* You mail the notices required in paragraph (a)(1) of this section to the consumer and allow the consumer to opt out by mailing a form, calling a toll-free telephone number, or any other reasonable means within 30 days from the date you mailed the notices.

(ii) *By electronic means.* A member opens an on-line account with you and agrees to receive the notices required in paragraph (a)(1) of this section electronically, and you make the notices available to the member on your web site and allow the member to opt out by any reasonable means within 30 days after the date that the member acknowledges receipt of the notices.

(iii) *Isolated transaction with consumer.* For an isolated transaction, such as the purchase of a traveler's check by a consumer, you provide the consumer with a reasonable opportunity to opt out if you provide the notices required in paragraph (a)(1) of this section at the time of the transaction and request that the consumer decide, as a necessary part of the transaction, whether to opt out before completing the transaction.

(b) *Application of opt out to all consumers and all nonpublic personal information.* (1) You must comply with this section, regardless of whether you and the consumer have established a member relationship.

(2) Unless you comply with this section, you may not, directly or through an affiliate, disclose any nonpublic personal information about a consumer that you have collected, regardless of whether you collected it before or after receiving the direction to opt out from the consumer.

(c) *Partial opt out.* You may allow a consumer to select certain nonpublic personal information or certain nonaffiliated third parties with respect to which the consumer wishes to opt out.

§ 716.11 Limits on redisclosure and reuse of information.

(a)(1) *Information you receive under an exception.* If you receive nonpublic personal information from a nonaffiliated financial institution under an exception in § 716.14 or 716.15 of this part, your disclosure and use of that information is limited as follows:

(i) You may disclose the information to the affiliates of the financial institution from which you received the information; and

(ii) You may disclose the information to your affiliates, but your affiliates may, in turn, disclose and use the information only to the extent that you may disclose and use the information; and

(iii) You may disclose and use the information pursuant to an exception in § 716.14 or 716.15 in the ordinary course of business to carry out the activity covered by the exception under which you received the information.

(2) *Example.* If you receive a member list from a credit union in order to provide correspondent services under the exception in § 716.14(a), you may disclose that information under any exception in § 716.14 or 716.15 in order to provide those services. For example, you could disclose the information in response to a properly authorized subpoena or to your attorneys, accountants, and auditors. You could not disclose that information to a third party for marketing purposes or use that information for your own marketing purposes.

(b)(1) *Information you receive outside of an exception.* If you receive nonpublic personal information from a nonaffiliated financial institution

other than under an exception in § 716.14 or 716.15 of this part, you may disclose the information only:

(i) To the affiliates of the financial institution from which you received the information;

(ii) To your affiliates, but your affiliates may, in turn, disclose the information only to the extent that you can disclose the information;

(iii) To any other person, if the disclosure would be lawful if made directly to that person by the financial institution from which you received the information; and

(iv) Pursuant to an exception in § 716.14 or 716.15.

(2) *Example.* If you obtain a customer list from a nonaffiliated financial institution outside of the exceptions in §§ 716.14 and 716.15,

(i) You may use the list for your own purposes;

(ii) You may disclose that list to another non-affiliated third party only if the financial institution from which you purchased the list could have disclosed the list to that third party, that is you may disclose the list in accordance with the privacy policy of the financial institution from which you received the list, as limited by the opt out direction of each consumer whose nonpublic personal information you intend to disclose; and

(iii) You may disclose that list as permitted by § 716.14 or 716.15, such as to your attorneys or accountants.

(c) *Information you disclose under an exception.* If you disclose nonpublic personal information to a nonaffiliated third party under an exception in § 716.14 or 716.15 of this part, the disclosure and use of that information by the third party is limited as follows:

(1) The third party may disclose the information to your affiliates;

(2) The third party may disclose the information to its affiliates, but its affiliates may, in turn, disclose and use the information only to the extent that the third party may disclose and use the information; and

(3) The third party may disclose and use the information pursuant to an exception in § 716.14 or 716.15 in the ordinary course of business to carry out the activity covered by the exception under which it received the information.

(d) *Information you disclose outside of an exception.* If you disclose nonpublic personal information to a nonaffiliated third party other than under an exception in § 716.14 or 716.15 of this part, the third party may disclose the information only:

(1) To your affiliates;

(2) To its affiliates, but its affiliates, in turn, may disclose the information only to the extent the third party can disclose the information;

(3) To any other person, if the disclosure would be lawful if made directly to that person by you; and

(4) Pursuant to an exception in § 716.14 or 716.15.

§ 716.12 Limits on sharing of account number information for marketing purposes.

(a) *General prohibition on disclosure of account numbers.* You must not, directly or through an affiliate, disclose, other than to a consumer reporting agency, an account number or similar form of access number or access code for a consumer's credit card account, share account or transaction account to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to the consumer.

(b) *Exceptions.* Paragraph (a) of this section does not apply if you disclose an account number or similar form of access number or access code:

(1) To your agent or service provider solely in order to perform marketing for your own products or services, as long as the agent or service provider cannot directly initiate charges to the account; or

(2) To a participant in a private label credit card program or an affinity or similar program where the participants in the program are identified to the member when the member enters into the program.

(c) *Examples.* (1) *Account number.* An account number, or similar form of access number or access code, does not include a number or code in an encrypted form, as long as you do not provide the recipient with a means to decode the number or code.

(2) *Transaction account.* A transaction account is an account other than a share or credit card account. A transaction account does not include an account to which a third party cannot initiate a charge.

Subpart C—Exceptions

§ 716.13 Exception to opt out requirements for service providers and joint marketing.

(a) *General rule.* (1) The opt out requirements in §§ 716.7 and 716.10 do not apply when you provide nonpublic personal information to a nonaffiliated third party to perform services for you or functions on your behalf, if you:

(i) Provide the initial notice in accordance with § 716.4; and

(ii) Enter into a contractual agreement with the third party that prohibits the third party from disclosing or using the information other than to carry out the purposes for which you disclosed the information, including use under an exception in § 716.14 or 716.15 in the ordinary course of business to carry out those purposes.

(2) *Example.* If you disclose nonpublic personal information under this section to a financial institution with which you perform joint marketing, your contractual agreement with that institution meets the requirements of paragraph (a)(1)(ii) of this section if it prohibits the institution from disclosing or using the nonpublic personal information except as necessary to carry out the joint marketing or under an exception in § 716.14 or 716.15 in the ordinary course of business to carry out that joint marketing.

(b) *Service may include joint marketing.* The services that a nonaffiliated third party performs for you under paragraph (a) of this section may include marketing of your own products or services or marketing of financial products or services offered pursuant to joint agreements between you and one or more financial institutions.

(c) *Definition of joint agreement.* For purposes of this section, *joint agreement* means a written contract pursuant to which you and one or more financial institutions jointly offer, endorse, or sponsor a financial product or service.

§ 716.14 Exceptions to notice and opt out requirements for processing and servicing transactions.

(a) *Exceptions for processing transactions at consumer's request.* The requirements for initial notice in § 716.4(a)(2), the opt out in §§ 716.7 and 716.10 and service providers and joint marketing in § 716.13 do not apply if you disclose nonpublic personal information as necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes, or in connection with:

(1) Servicing or processing a financial product or service that a consumer requests or authorizes;

(2) Maintaining or servicing the consumer's account with you, or with another entity as part of a private label credit card program or other extension of credit on behalf of such entity; or

(3) A proposed or actual securitization, secondary market sale (including sales of servicing rights) or similar transaction related to a transaction of the consumer.

(b) *Necessary to effect, administer, or enforce a transaction* means that the disclosure is:

(1) Required, or is one of the lawful or appropriate methods, to enforce your rights or the rights of other persons engaged in carrying out the financial transaction or providing the product or service; or

(2) Required, or is a usual, appropriate or acceptable method:

(i) To carry out the transaction or the product or service business of which the transaction is a part, and record, service or maintain the consumer's account in the ordinary course of providing the financial service or financial product;

(ii) To administer or service benefits or claims relating to the transaction or the product or service business of which it is a part;

(iii) To provide a confirmation, statement or other record of the transaction, or information on the status or value of the financial service or financial product to the consumer or the consumer's agent or broker;

(iv) To accrue or recognize incentives or bonuses associated with the transaction that are provided by you or any other party;

(v) In connection with:

(A) The authorization, settlement, billing, processing, clearing, transferring, reconciling or collection of amounts charged, debited, or otherwise paid using a debit, credit or other payment card, check or account number, or by other payment means;

(B) The transfer of receivables, accounts or interests therein; or

(C) The audit of debit, credit or other payment information.

§ 716.15 Other exceptions to notice and opt out requirements.

(a) *Exceptions to opt out requirements.* The requirements for initial notice to consumers in § 716.4(a)(2), the opt out in §§ 716.7 and 716.10 and service providers and joint marketing in § 716.13 do not apply when you disclose nonpublic personal information:

(1) With the consent or at the direction of the consumer, provided that the consumer has not revoked the consent or direction;

(2)(i) To protect the confidentiality or security of your records pertaining to the consumer, service, product or transaction;

(ii) To protect against or prevent actual or potential fraud, unauthorized transactions, claims or other liability;

(iii) For required institutional risk control or for resolving consumer disputes or inquiries;

(iv) To persons holding a legal or beneficial interest relating to the consumer; or

(v) To persons acting in a fiduciary or representative capacity on behalf of the consumer;

(3) To provide information to insurance rate advisory organizations, guaranty funds or agencies, agencies that are rating you, persons that are assessing your compliance with industry standards, and your attorneys, accountants, and auditors;

(4) To the extent specifically permitted or required under other provisions of law and in accordance with the Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 *et seq.*), to law enforcement agencies (including a federal functional regulator, the Secretary of the Treasury, with respect to 31 U.S.C. Chapter 53, Subchapter II (Records and Reports on Monetary Instruments and Transactions) and 12 U.S.C. Chapter 21 (Financial Recordkeeping), a state insurance authority, with respect to any person domiciled in that insurance authority's state that is engaged in providing insurance, and the Federal Trade Commission), self-regulatory organizations, or for an investigation on a matter related to public safety;

(5)(i) To a consumer reporting agency in accordance with the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*), or

(ii) From a consumer report reported by a consumer reporting agency;

(6) In connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit if the disclosure of nonpublic personal information concerns solely consumers of such business or unit; or

(7)(i) To comply with federal, state or local laws, rules and other applicable legal requirements;

(ii) To comply with a properly authorized civil, criminal or regulatory investigation, or subpoena or summons by federal, state or local authorities; or

(iii) To respond to judicial process or government regulatory authorities having jurisdiction over you for examination, compliance or other purposes as authorized by law.

(b) *Examples of consent and revocation of consent.* (1) A consumer may specifically consent to your disclosure to a nonaffiliated insurance company of the fact that the consumer has applied to you for a mortgage so that the insurance company can offer homeowner's insurance to the consumer.

(2) A consumer may revoke consent by subsequently exercising the right to opt out of future disclosures of nonpublic personal information as permitted under § 716.7(f).

Subpart D—Relation to Other Laws; Effective Date

§ 716.16 Protection of Fair Credit Reporting Act.

Nothing in this part shall be construed to modify, limit, or supersede the operation of the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*), and no inference shall be drawn on the basis of the provisions of this part regarding whether information is transaction or experience information under section 603 of that Act.

§ 716.17 Relation to state laws.

(a) *In general.* This part shall not be construed as superseding, altering, or affecting any statute, regulation, order or interpretation in effect in any state, except to the extent that such state statute, regulation, order or interpretation is inconsistent

with the provisions of this part, and then only to the extent of the inconsistency.

(b) *Greater protection under state law.* For purposes of this section, a state statute, regulation, order or interpretation is not inconsistent with the provisions of this part if the protection such statute, regulation, order or interpretation affords any consumer is greater than the protection provided under this part, as determined by the Federal Trade Commission, after consultation with the National Credit Union Administration, on the Federal Trade Commission's own motion or upon the petition of any interested party.

§ 716.18 Effective date; transition rule.

(a) *Effective date.* This part is effective November 13, 2000. In order to provide sufficient time for you to establish policies and systems to comply with the requirements of this part, the National Credit Union Administration Board has extended the time for compliance with this part until July 1, 2001.

(b)(1) *Notice requirement for consumers who were your members on the compliance date.* By July 1, 2001, you must provide an initial notice, as required by § 716.4, to consumers who are your members on July 1, 2001.

(2) *Example.* You provide an initial notice to consumers who are your members on July 1, 2001, if, by that date, you have established a system for providing an initial notice to all new members and have mailed the initial notice to all your existing members.

(c) *Two-year grandfathering of service agreements.* Until July 1, 2002, a contract that you have entered into with a nonaffiliated third party to perform services for you or functions on your behalf satisfies the provisions of § 716.13(a)(2) of this part, even if the contract does not include a requirement that the third party maintain the confidentiality of nonpublic personal information, as long as the agreement was entered into on or before July 1, 2000.

Appendix A to Part 716—Sample Clauses

Credit unions, including a group of affiliates that use a common privacy notice, may use the following sample clauses, if the clause is accurate for each institution that uses the notice.

A–1—Categories of information you collect (all credit unions)

You may use this clause, as applicable, to meet the requirement of § 716.6(a)(1) to describe the categories of nonpublic personal information you collect.

Sample Clause A–1:

We collect nonpublic personal information about you from the following sources:

- Information we receive from you on applications or other forms;
- Information about your transactions with us, our affiliates, or others; and
- Information we receive from a consumer reporting agency.

A–2—Categories of information you disclose (credit unions that disclose outside of the exceptions)

You may use one of these clauses, as applicable, to meet the requirement of § 716.6(a)(2) to describe the categories of nonpublic personal information you disclose. These clauses may be used if you disclose nonpublic personal information other than as permitted by the exceptions in §§ 716.13, 716.14, and 716.15.

Sample Clause A–2, Alternative 1:

We may disclose the following kinds of nonpublic personal information about you:

- Information we receive from you on applications or other forms, such as [*provide illustrative examples, such as "your name, address, social security number, assets, and income"*];
- Information about your transactions with us, our affiliates, or others, such as [*provide illustrative examples, such as "your account balance, payment history, parties to transactions, and credit card usage"*]; and
- Information we receive from a consumer reporting agency, such as [*provide illustrative examples, such as "your creditworthiness and credit history"*].

Sample Clause A–2, Alternative 2:

We may disclose all of the information that we collect, as described [*describe location in the notice, such as "above" or "below"*].

A–3—Categories of information you disclose and parties to whom you disclose (credit unions that do not disclose outside of the exceptions)

You may use this clause, as applicable, to meet the requirements of § 716.6(a)(2), (3) and (4) to describe the categories of nonpublic personal information about members and former members that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose. This clause may be used if you do not disclose nonpublic personal information to any party, other than as permitted by the exceptions in §§ 716.14, and 716.15.

Sample Clause A–3:

We do not disclose any nonpublic personal information about our members and former members to anyone, except as permitted by law.

A–4—Categories of parties to whom you disclose (credit unions that disclose outside of the exceptions)

You may use this clause, as applicable, to meet the requirement of § 716.6(a)(3) to describe the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information. This clause may be used if you disclose nonpublic personal information other than as permitted by the exceptions in §§ 716.13, 716.14, and 716.15, as well as when permitted by the exceptions in §§ 716.14, and 716.15.

Sample Clause A–4:

We may disclose nonpublic personal information about you to the following types of third parties:

- Financial service providers, such as [*provide illustrative examples, such as "mortgage bankers, securities broker-dealers, and insurance agents"*];
- Non-financial companies, such as [*provide illustrative examples, such as "retailers, direct marketers, airlines, and publishers"*]; and
- Others, such as [*provide illustrative examples, such as "non-profit organizations"*].

We may also disclose nonpublic personal information about you to nonaffiliated third parties as permitted by law.

A–5—Service provider/joint marketing exception

You may use one of these clauses, as applicable, to meet the requirements of § 716.6(a)(5) related to the exception for service providers and joint marketers in § 716.13. If you disclose nonpublic personal information under this exception, you must describe the categories of nonpublic personal information you disclose and the categories of third parties with whom you have contracted.

Sample Clause A–5, Alternative 1:

We may disclose the following information to companies that perform marketing services on our behalf or to other financial institutions with whom we have joint marketing agreements:

- Information we receive from you on applications or other forms, such as [*provide illustrative examples, such as "your name, address, social security number, assets, and income"*];
- Information about your transactions with us, our affiliates, or others, such as [*provide illustrative examples, such as "your account balance, payment history, parties to transactions, and credit card usage"*]; and
- Information we receive from a consumer reporting agency, such as [*provide illustrative examples, such as "your creditworthiness and credit history"].*

Sample Clause A–5, Alternative 2:

We may disclose all of the information we collect, as described [*describe location in the notice, such as "above" or "below"*] to companies that perform marketing services on our behalf or to other financial institutions with whom we have joint marketing agreements.

A–6—Explanation of opt out right (credit unions that disclose outside of the exceptions)

You may use this clause, as applicable, to meet the requirement of § 716.6(a)(6) to provide an explanation of the consumer's right to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including the method(s) by which the consumer may exercise that right. This clause may be used if you disclose nonpublic personal information other than as permitted by the exceptions in §§ 716.13, 716.14, and 716.15.

Sample Clause A–6:

If you prefer that we not disclose nonpublic personal information about you to nonaffiliated third parties, you may opt out of those disclosures, that is, you may direct us not to make those disclosures

(other than disclosures permitted by law). If you wish to opt out of disclosures to nonaffiliated third parties, you may [*describe a reasonable means of opting out, such as "call the following toll-free number: (insert number)*].

A–7—Confidentiality and security (all credit unions)

You may use this clause, as applicable, to meet the requirement of § 716.6(a)(8) to describe your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information.

Sample Clause A–7:

We restrict access to nonpublic personal information about you to [*provide an appropriate description, such as "those employees who need to know that information to provide products or services to you"*]. We maintain physical, electronic, and procedural safeguards that comply with federal regulations to guard your nonpublic personal information.

Part 721

Incidental Powers

§ 721.1 What does this part cover?

This part authorizes a federal credit union (you) to engage in activities incidental to your business as set out in this part. This part also describes how interested parties may request a legal opinion on whether an activity is within a federal credit union's incidental powers or apply to add new activities or categories to the regulation. An activity approved in a legal opinion to an interested party or as a result of an application by an interested party to add new activities or categories is recognized as an incidental powers activity for all federal credit unions. This part does not apply to the activities of corporate credit unions.

§ 721.2 What is an incidental powers activity?

An incidental powers activity is one that is necessary or requisite to enable you to carry on effectively the business for which you are incorporated. An activity meets the definition of an incidental power activity if the activity:

(a) Is convenient or useful in carrying out the mission or business of credit unions consistent with the Federal Credit Union Act;

(b) Is the functional equivalent or logical outgrowth of activities that are part of the mission or business of credit unions; and

(c) Involves risks similar in nature to those already assumed as part of the business of credit unions.

§ 721.3 What categories of activities are preapproved as incidental powers necessary or requisite to carry on a credit union's business?

The categories of activities in this section are preapproved as incidental to carrying on your business under § 721.2. The examples of incidental powers activities within each category are provided in this section as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

(a) *Certification services.* Certification services are services whereby you attest or authenticate a fact for your members' use. Certification services may include such services as notary services, signature guarantees, certification of electronic signatures, and share draft certifications.

(b) *Correspondent services.* Correspondent services are services you provide to other credit unions that you are authorized to perform for your members or as part of your operation. These services may include loan processing, loan servicing, member check cashing services, disbursing share withdrawals and loan proceeds, cashing and selling money orders, performing internal audits, and automated teller machine deposit services.

(c) *Electronic financial services.* Electronic financial services are any services, products, functions, or activities that you are otherwise authorized to perform, provide, or deliver to your members but performed through electronic means. Electronic services may include automated teller machines, electronic fund transfers, online transaction processing through a web site, web site hosting services, account aggregation services, and Internet access services to perform or deliver products or services to members.

(d) *Excess capacity.* Excess capacity is the excess use or capacity remaining in facilities, equipment, or services that: You properly invested in or established, in good faith, with the intent of serving your members; and you reasonably anticipate will be taken up by the future expansion of services to your members. You may sell or lease the excess capacity in facilities, equipment or services such as office space, employees and data processing.

(e) *Financial counseling services.* Financial counseling services means advice, guidance or services that you offer to your members to promote thrift or to otherwise assist members on financial matters. Financial counseling services may include income tax preparation service, electronic tax filing for your members, counseling regarding estate and retirement planning, investment counseling, and debt and budget counseling.

(f) *Finder activities.* Finder activities are activities in which you introduce or otherwise bring together outside vendors with your members so that

the two parties may negotiate and consummate transactions. Finder activities may include offering third party products and services to members through the sale of advertising space on your web site, account statements and receipts, or selling statistical or consumer financial information to outside vendors to facilitate the sale of their products to your members.

(g) *Loan-related products.* Loan-related products are the products, activities or services you provide to your members in a lending transaction that protect you against credit-related risks or are otherwise incidental to your lending authority. These products or activities may include debt cancellation agreements, debt suspension agreements, letters of credit and leases.

(h) *Marketing activities.* Marketing activities are the activities or means you use to promote membership in your credit union and the products and services you offer to your members. Marketing activities may include advertising and other promotional activities such as raffles, membership referral drives, and the purchase or use of advertising.

(i) *Monetary instrument services.* Monetary instrument services are services that enable your members to purchase, sell, or exchange various currencies. These services may include the sale and exchange of foreign currency and U.S. commemorative coins. You may also use accounts you have in foreign financial institutions to facilitate your members' transfer and negotiation of checks denominated in foreign currency or engage in monetary transfer services for your members.

(j) *Operational programs.* Operational programs are programs that you establish within your business to establish or deliver products and services that enhance member service and promote safe and sound operation. Operational programs may include electronic funds transfers, remote tellers, point of purchase terminals, debit cards, payroll deduction, pre-authorized member transactions, direct deposit, check clearing services, savings bond purchases and redemptions, tax payment services, wire transfers, safe deposit boxes, loan collection services, and service fees.

(k) *Stored value products.* Stored value products are alternate media to currency in which you transfer monetary value to the product and create a medium of exchange for your members' use. Examples of stored value products include stored value cards, public transportation tickets, event and attraction tickets, gift certificates, prepaid phone cards, postage stamps, electronic benefits transfer script, and similar media.

(l) *Trustee or custodial services.* Trustee or custodial services are services in which you are authorized to act under any written trust instrument or custodial agreement created or organized in the United States and forming part of a pension or profit-sharing plan, as authorized under the Internal Revenue Code. These services may include acting as a trustee or custodian for member retirement and education accounts.

§ 721.4 How may a credit union apply to engage in an activity that is not preapproved as within a credit union's incidental powers?

(a) *Application contents.* To engage in an activity that may be within an FCU's incidental powers but that does not fall within a preapproved category listed in § 721.3, you may submit an application by certified mail, return receipt requested, to the NCUA Board. Your application must describe the activity, your explanation, consistent with the test provided in paragraph (c) of this section, of why this activity is within your incidental powers, your plan for implementing the proposed activity, any state licenses you must obtain to conduct the activity, and any other information necessary to describe the proposed activity adequately. Before you engage in the petition process you should seek an advisory opinion from NCUA's Office of General Counsel, as to whether a proposed activity fits into one of the authorized categories or is otherwise within your incidental powers without filing a petition to amend the regulation.

(b) *Processing of application.* Your application must be filed with the Secretary of the NCUA Board. NCUA will review your application for completeness and will notify you whether additional information is required or whether the activity requested is permissible under one of the categories listed in § 721.3. If the activity falls within a category provided in § 721.3, NCUA will notify you that the activity is permissible and treat the application as withdrawn. If the activity does not fall within a category provided in § 721.3, NCUA staff will consider whether the proposed activity is legally permissible. Upon a recommendation by NCUA staff that the activity is within a credit union's incidental powers, the NCUA Board may amend § 721.3 and will request public comment on the establishment of a new category of activities within § 721.3. If the activity proposed in your ap-

plication fails to meet the criteria established in paragraph (c) of this section, NCUA will notify you within a reasonable period of time.

(c) *Decision on application.* In determining whether an activity is authorized as an appropriate exercise of a federal credit union's incidental powers, the Board will consider:

(1) Whether the activity is convenient or useful in carrying out the mission or business of credit unions consistent with the Act;

(2) Whether the activity is the functional equivalent or logical outgrowth of activities that are part of the mission or business of credit unions; and

(3) Whether the activity involves risks similar in nature to those already assumed as part of the business of credit unions.

§ 721.5 What limitations apply to a credit union engaging in activities approved under this part?

You must comply with any applicable NCUA regulations, policies, and legal opinions, as well as applicable state and federal law, if an activity authorized under this part is otherwise regulated or conditioned.

§ 721.6 May a credit union derive income from activities approved under this part?

You may earn income for those activities determined to be incidental to your business.

§ 721.7 What are the potential conflicts of interest for officials and employees when credit unions engage in activities approved under this part?

(a) *Conflicts.* No official, employee, or their immediate family member may receive any compensation or benefit, directly or indirectly, in connection with your engagement in an activity authorized under this part, except as otherwise provided in paragraph (b) of this section. This section does not apply if a conflicts of interest provision within another section of this chapter applies to a particular activity; in such case, the more specific conflicts of interest provision controls. For example: An official or employee that refers loan-related products offered by a third-party to a member, in connection with a loan made by you, is subject to the conflicts of interest provision in § 701.21(c)(8) of this chapter.

(b) *Permissible payments.* This section does not prohibit:

(1) Payment, by you, of salary to your employees;

(2) Payment, by you, of an incentive or bonus to an employee based on your overall financial performance;

(3) Payment, by you, of an incentive or bonus to an employee, other than a senior management employee or paid official, in connection with an activity authorized by this part, provided that your board of directors establishes written policies and internal controls for the incentive program and monitors compliance with such policies and controls at least annually; and

(4) Payment, by a person other than you, of any compensation or benefit to an employee, other than a senior management employee or paid official, in connection with an activity authorized by this part, provided that your board of directors establishes written policies and internal controls regarding third-party compensation and determines that the employee's involvement does not present a conflict of interest.

(c) *Business associates and family members.* All transactions with business associates or family members not specifically prohibited by paragraph (a) of this section must be conducted at arm's length and in the interest of the credit union.

(d) *Definitions.* For purposes of this part, the following definitions apply.

(1) *Senior management employee* means your chief executive officer (typically, this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g. Assistant President, Vice President, or Assistant Treasurer/Manager), and the chief financial officer (Comptroller).

(2) *Official* means any member of your board of directors, credit committee or supervisory committee.

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

Part 722

Appraisals

§ 722.1 Authority, Purpose, and Scope.

(a) *Authority.* Part 722 is issued by the National Credit Union Administration ("NCUA") under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (Pub. L. No. 101–73, 103 Stat. 183, 1989) and 12 U.S.C. 1757 and 1766.

(b) *Purpose and Scope.* (1) Title XI provides protection for federal financial and public policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This Part implements the requirements of Title XI and applies to all federally related transactions entered into by the National Credit Union Administration or by federally insured credit unions ("regulated institutions").

(2) This Part:

(i) identifies which real estate-related financial transactions require the services of an appraiser;

(ii) prescribes which categories of federally related transactions shall he appraised by a state-certified appraiser and which by a state-licensed appraiser; and

(iii) prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the National Credit Union Administration.

§ 722.2 Definitions.

(a) "Appraisal" means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately-described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(b) "Appraisal Foundation" means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) "Appraisal Subcommittee" means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(d) "Complex 1-to-4 family residential property appraisal" means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

(e) "Federally related transaction" means any real estate-related financial transaction entered into on or after August 9, 1990, that:

(1) the National Credit Union Administration, or any federally insured credit union, engages in or contracts for; and

(2) requires the services of an appraiser.

(f) "Market value" means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably and as suming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(1) buyer and seller are typically motivated;

(2) both parties are well informed or well advised, and acting in what they consider their own best interests;

(3) a reasonable time is allowed for exposure in the open market;

(4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(g) "Real estate or real property" means an identified parcel or tract of land, including easements, rights of way, undivided or future interests and similar rights in a parcel or tract of land, but does not include mineral rights, timber rights, and growing crops, water rights and similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

(h) "Real estate-related financial transaction" means any transaction involving:

(1) the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof; or

(2) the refinancing of real property or interests in real property; or

(3) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

(i) "State-certified appraiser" means any individual who has satisfied the requirements for certification in a state or territory whose criteria for certification as a real estate appraiser currently meet the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. No individual shall be a state-certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a state or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of a state or territory are inconsistent with Title XI of FIRREA. The National Credit Union Administration may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(j) "State-licensed appraiser" means any individual who has satisfied the requirements for licensing in a state or territory where the licensing procedures comply with Title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the state or territory are inconsistent with Title XI. The NCUA may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(k) "Tract development" means a project of five units or more that is constructed or is to be constructed as a single development.

(l) "Transaction value" means:

(1) for loans or other extensions of credit, the amount of the loan or extension of credit;

(2) for sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) for the pooling of loans or interests in real property for resale or purchase, the amount of the loan or market value of the real property calculated with respect to each such loan or interest in real property.

§ 722.3 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $250,000 or less;

(2) A lien on real property has been taken as collateral through an abundance of caution and where the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of a lien;

(3) A lien on real estate has been taken for purposes other than the real estate's value;

(4) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(5) The transaction involves an existing extension of credit at the credit union, provided that:

(i) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs; and

(ii) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the credit union's real estate collateral protection after the transaction;

(6) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met the requirements of this regulation, if applicable, at the time of origination;

(7) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency;

(8) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate; or

(9) The regional director has granted a waiver from the appraisal requirement for a category of loans meeting the definition of a member business loan.

(b) *Transactions Requiring a State-Certified Appraiser.*

(1) (All transactions of $1,000,000 or more) All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a state-certified appraiser.

(2) (Nonresidential transactions) All federally related transactions having a transaction value of more than $250,000, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a state-certified appraiser.

(3) (Complex residential transactions of $250,000 or more) All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a state-certified appraiser if the transaction value is $250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If, during the course of the appraisal, a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) the regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and cosign the appraisal; or

(ii) the institution may engage a certified appraiser to complete the appraisal.

(c) *Transactions Requiring Either a State-Certified or -Licensed Appraiser.* All appraisals for federally related transactions not requiring the services of a state-certified appraiser shall be prepared by either a state-certified appraiser or a state-licensed appraiser.

(d) *Valuation requirement.* Secured transactions exempted from appraisal requirements pursuant to paragraphs (a)(1) and (a)(5) of this section and not otherwise exempted from this regulation or fully insured shall be supported by a written estimate of market value, as defined in this part, performed by an individual having no direct or indirect interest in the property, and qualified and experienced to perform such estimates of value for the type and amount of credit being considered.

(e) *Appraisals to address safety and soundness concerns.* NCUA reserves the right to require an appraisal under this part whenever the agency believes it is necessary to address safety and soundness concerns.

§ 722.4 Minimum appraisal standards.

For federally related transactions, all appraisals shall, at a minimum:

(a) Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation, 1029 Vermont Ave., NW., Washington, DC 20005;

(b) Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;

(c) Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units;

(d) Be based upon the definition of market value as set forth in § 722.2(f); and

(e) Be performed by State licensed or certified appraisers in accordance with requirements set forth in this part.

§ 722.5 Appraiser Independence.

(a) *Staff Appraiser.* If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the credit union, the credit union shall take appropriate steps to ensure that the appraisers exercise independent judgment. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with feder-

ally related transactions in which the appraiser is otherwise involved.

(b) *Fee Appraisers.* (1) If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the credit union or its agent and have no direct or indirect interest, financial or otherwise, in the property or the transaction.

(2) A credit union also may accept an appraisal that was prepared by an appraiser engaged directly by another financial services institution; if:

(i) the appraiser has no direct or indirect interest, financial or otherwise, in the property or transaction; and

(ii) the credit union determines that the appraisal conforms to the requirement of this part and is otherwise acceptable.

§ 722.6 Professional Association Membership; Competency.

(a) *Membership in Appraisal Organization.* A state-certified appraiser or a state-licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be state-certified or -licensed as appropriate. However, a state-certified or -licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

§ 722.7 Enforcement.

Credit unions and institution-affiliated parties, including staff appraisers, may be subject to removal and/or prohibition orders, cease-and-desist orders, and the imposition of civil money penalties pursuant to Section 1786 of the Federal Credit Union Act, or any other applicable law.

Part 723

Member Business Loans

§ 723.1 What is a member business loan?

(a) *General rule.* A member business loan includes any loan, line of credit, or letter of credit (including any unfunded commitments) where the borrower uses the proceeds for the following purposes:

(1) Commercial;

(2) Corporate;

(3) Other business investment property or venture; or

(4) Agricultural.

(b) *Exceptions to the general rule.* The following are not member business loans:

(1) A loan fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;

(2) A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;

(3) Loan(s) to a member or an associated member which, when the net member business loan balances are added together, are equal to less than $50,000;

(4) A loan where a federal or state agency (or its political subdivision) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full; or

(5) A loan granted by a corporate credit union to another credit union.

(c) *Loans to credit unions and credit union service organizations.* This part does not apply to loans made by federal credit unions to credit unions and credit union service organizations. This part does not apply to loans made by a federally insured, state-chartered credit union to credit unions and credit union service organizations if the credit union's supervisory authority determines that state law grants authority to lend to these entities other than the general authority to grant loans to members.

(d) *Purchase of member loans and member loan participations.* Any interest a credit union obtains in a loan that was made by another lender to the credit union's member is a member business loan, for purposes of this rule and the risk weighting standards of part 702 of this chapter to the same extent as if made directly by the credit union to its member.

(e) *Purchases of nonmember loans and nonmember loan participations.* Any interest a credit union obtains in a nonmember loan, pursuant to § 701.22 or part 742 of this chapter or other authority, is treated the same as a member business loan for purposes of this rule and the risk weighting standards under part 702 of this chapter, except that the effect of such interest on a credit union's aggregate member business loan limit will be as set forth in § 723.16(b) of this part.

§ 723.2 What are the prohibited activities?

(a) *Who is ineligible to receive a member business loan?* You may not grant a member business loan to the following:

(1) Your chief executive officer (typically this individual holds the title of President or Treasurer/Manager);

(2) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager);

(3) Your chief financial officer (Comptroller); or

(4) Any associated member or immediate family member of anyone listed in paragraphs (a) (1) through (3) of this section.

(b) *Equity agreements/joint ventures.* You may not grant a member business loan if any additional income received by the credit union or senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

(c) *Loans to compensated directors.* A credit union may not grant a member business loan to a compensated director unless the board of directors approves granting the loan and the compensated director is recused from the decision making process.

§ 723.3 What are the requirements for construction and development lending?

Unless the Regional Director grants a waiver, loans granted for the construction or development of commercial or residential property are subject to the following additional requirements.

(a) The aggregate of the net member business loan balances for all construction and development loans must not exceed 15% of net worth. In determining the aggregate balances for purposes of this limitation, a credit union may exclude any loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and may also exclude a loan to finance the construction of one single-family residence per member-borrower or group of associated member-borrowers, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property.

(b) The borrower must have a minimum of 25% equity interest in the project being financed, the value of which is determined by the market value of the project at the time the loan is made, except that this requirement will not apply in the case of a loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and in the case of one loan to a member-borrower or group of associated member-borrowers to finance the construction of a single-family residence, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property. Instead, the collateral requirements of § 723.7 will apply; and

(c) The funds may be released only after onsite, written inspections by qualified personnel and according to a preapproved draw schedule and any other conditions as set forth in the loan documentation.

§ 723.4 What are the other applicable regulations?

The provisions of § 701.21(a) through (g) of this chapter apply to member business loans granted by federal credit unions to the extent they are consistent with this part. Except as required by part 741 of this chapter, federally insured state-chartered credit unions are not required to comply with the provisions of § 701.21(a) through (g) of this chapter.

§ 723.5 How do you implement a member business loan program?

(a) *Generally.* The board of directors must adopt specific business loan policies and review them at least annually. The board must also use the services of an individual with at least two years direct experience with the type of lending the credit union will be engaging in. The experience must provide the credit union sufficient expertise given the complexity and risk exposure of the loans in which the credit union intends to engage. Credit unions do not have to hire staff to meet the requirements of this section but must ensure that the expertise is available. A credit union can meet the experience requirement through various approaches. For example, a credit union can use the services of a credit union service organization (CUSO), an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

(b) *Conflicts of Interest.* Any third party used by a credit union to meet the requirements of paragraph (a) of this section must be independent from the transaction and is prohibited from having a participation in the loan or an interest in the collateral securing the loan that the third party is responsible for reviewing, with the following exceptions:

(1) The third party may provide a service to the credit union related to the transaction, such as loan servicing;

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

(3) A credit union may use the services of a CUSO that otherwise meets the requirements of paragraph (a) of this section even though the CUSO is not independent from the transaction, provided the credit union has a controlling financial interest in the CUSO as determined under Generally Accepted Accounting Principles.

§ 723.6 What must your member business loan policy address?

At a minimum, your policy must address the following:

(a) The types of business loans you will make;

(b) Your trade area;

(c) The maximum amount of your assets, in relation to net worth, that you will invest in secured and unsecured business loans;

(d) The maximum amount of your assets, in relation to net worth, that you will invest in a given category or type of business loan;

(e) The maximum amount of your assets, in relation to net worth, that you will loan to any one member or group of associated members, subject to § 723.7(c)(2) and § 723.8;

(f) The qualifications and experience of personnel (minimum of 2 years) involved in making and administering business loans;

(g) A requirement to analyze and document the ability of the borrower to repay the loan consistent with appropriate underwriting and due diligence standards, which also addresses the need for periodic financial statements, credit reports, and other data when necessary to analyze future loans and lines of credit, such as, borrower's history and experience, balance sheet, cash flow analysis, income statements, tax data, environmental impact assessment, and comparison with industry averages, depending upon the loan purpose;

(h) The collateral requirements must include:

(1) Loan-to-value ratios;

(2) Determination of value;

(3) Determination of ownership;

(4) Steps to secure various types of collateral; and

(5) How often the credit union will reevaluate the value and marketability of collateral;

(i) The interest rates and maturities of business loans;

(j) General loan procedures which include:

(1) Loan monitoring;

(2) Servicing and follow-up; and

(3) Collection;

(k) Identification of those individuals prohibited from receiving member business loans.

§ 723.7 What are the collateral and security requirements?

(a) Unless your Regional Director grants a waiver, all member business loans, except those made under paragraphs (c), (d), and (e), must be secured by collateral as follows:

(1) The maximum loan-to-value ratio for all liens must not exceed 80% unless the value in excess of 80% is covered through private mortgage insurance or equivalent type of insurance, or insured, guaranteed, or subject to advance commitment to purchase by an agency of the federal government, an agency of a state or any of its political subdivisions, but in no case may the ratio exceed 95%;

(2) A borrower may not substitute any insurance, guarantee, or advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state for the collateral requirements of this paragraph.

(b) Principals, other than a not for profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501) or those where the Regional Director grants a waiver, must provide their personal liability and guarantee. Federal credit unions and federally insured state-chartered credit unions that meet RegFlex standards, as determined pursuant to Part 742 of this Chapter, are exempt from this requirement and may make their own determination whether to require the personal liability and guarantee of principals.

(c) You may make unsecured member business loans under the following conditions:

(1) You are well capitalized as defined by § 702.102(a)(1) of this chapter;

(2) The aggregate of the unsecured outstanding member business loans to any one member or group of associated members does not exceed the lesser of $100,000 or 2.5% of your net worth; and

(3) The aggregate of all unsecured outstanding member business loans does not exceed 10% of your net worth.

(d) You are exempt from the provisions of paragraphs (a), (b), and (c) of this section with respect to credit card line of credit programs offered to nonnatural person members that are limited to routine purposes normally made available under those programs.

(e) You may make vehicle loans under this part without complying with the loan-to-value ratios in this section, provided that the vehicle is a car, van, pick-up truck, or sports utility vehicle and not part of a fleet of vehicles.

§ 723.8 How much may one member or a group of associated members borrow?

Unless your Regional Director grants a waiver for a higher amount, the aggregate amount of net member business loan balances to any one mem-

ber or group of associated members must not exceed the greater of:

(a) 15% of the credit union's net worth; or

(b) $100,000.

§ 723.9 Removed and Reserved.

§ 723.10 What waivers are available?

You may seek a waiver for a category of loans in any of the following areas:

(a) Appraisal requirements under § 722.3;

(b) Aggregate construction and development loans limits under § 723.3(a);

(c) Minimum borrower equity requirements for construction and development loans under § 723.3(b);

(d) Loan-to-value ratio requirements for business loans under § 723.7(a);

(e) Requirement for personal liability and guarantee under § 723.7(b);

(f) Maximum unsecured business loans to one member or group of associated members under § 723.7(c)(2);

(g) Maximum aggregate unsecured member business loan limit under § 723.7(c)(3); and

(h) Maximum aggregate outstanding member business loan balance to any one member or group of associated members under § 723.8.

§ 723.11 How do you obtain a waiver?

To obtain a waiver, a federal credit union must submit a request to the Regional Director (a corporate federal credit union submits the waiver request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the request to the Regional Director (or if appropriate the Director of the Office of Corporate Credit Unions). A waiver is not effective until it is approved by the Regional Director (or in the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The waiver request must contain the following:

(a) A copy of your business lending policy;

(b) The higher limit sought (if applicable);

(c) An explanation of the need to raise the limit (if applicable);

(d) Documentation supporting your ability to manage this activity; and

(e) An analysis of the credit union's prior experience making member business loans, including as a minimum:

(1) The history of loan losses and loan delinquency;

(2) Volume and cyclical or seasonal patterns;

(3) Diversification;

(4) Concentrations of credit to one borrower or group of associated borrowers in excess of 15% of net worth;

(5) Underwriting standards and practices;

(6) Types of loans grouped by purpose and collateral; and

(7) The qualifications of personnel responsible for underwriting and administering member business loans.

§ 723.12 What will NCUA do with my waiver request?

Your Regional Director (or the Director of the Office of Corporate Credit Unions) will:

(a) Review the information you provided in your request;

(b) Evaluate the level of risk to your credit union;

(c) Consider your credit union's historical CAMEL composite and component ratings when evaluating your request; and

(d) Notify you whenever your waiver request is deemed complete. Notify you of the action taken within 45 calendar days of receiving a complete request from the federal credit union or the state supervisory authority. If you do not receive notification within 45 calendar days of the date the complete request was received by the regional office, the credit union may assume approval of the waiver request.

§ 723.13 What options are available if the NCUA Regional Director denies my waiver request or a portion of it?

You may appeal the Regional Director's (or the Director of the Office of Corporate Credit Unions) decision in writing to the NCUA Board. Your appeal must include all information requested in § 723.11 and why you disagree with your Regional Director's (or the Office of Corporate Credit Union Director's) decision.

§ 723.14 Removed and Reserved.

§ 723.15 Removed and Reserved.

§ 723.16 What is the aggregate member business loan limit for a credit union?

(a) *General.* The aggregate limit on a credit union's net member business loan balances is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities. Loans that are exempt from the definition of member business loans are not counted for the purpose of the aggregate loan limit.

(b) *Effect of nonmember loans and nonmember participations.* If a credit union holds any nonmember loans or nonmember loan participation interests that would constitute a member business loan if made to a member, those loans will affect the credit union's aggregate limit on net member business loan balances as follows:

(1) The total of the credit union's net member business loan balances and the nonmember loan balances must not exceed the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets, unless the credit union has first received approval from the NCUA regional director.

(2) To request approval from the NCUA regional director, a credit union must submit an application that:

(i) Includes a current copy of the credit union's member business loan policies;

(ii) Confirms that the credit union is in compliance with all other aspects of this rule;

(iii) States the credit union's proposed limit on the total amount of nonmember loans and participation interests that the credit union may acquire if the application is granted; and

(iv) Attests that the acquisition of nonmember loans and participations is not being used, in conjunction with one or more other credit unions, to have the effect of trading member business loans that would otherwise exceed the aggregate limit.

(3) A federal credit union must submit its request for approval to the regional director (a corporate federal credit union submits its request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the application and its decision to the regional director (or if appropriate, the Director of the Office of Corporate Credit Unions). An approved application is not effective until it is approved by the regional director (or in the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The regional director will issue a decision within 30 days of receipt of a federal credit union's completed application or within 30 days of receipt of a completed application and the state supervisory authority's approval for a state chartered federally insured credit union.

§ 723.17 Are there any exceptions to the aggregate loan limit?

There are three circumstances where a credit union qualifies for an exception from the aggregate limit. Loans that are excepted from the definition of member business loans are not counted for the purpose of the exceptions. The three exceptions are:

(a) Credit unions that have a low-income designation or participate in the Community Development Financial Institutions program;

(b) Credit unions that were chartered for the purpose of making member business loans and can provide documentary evidence (such evidence includes but is not limited to the original charter, original bylaws, original business plan, original field of membership, board minutes and loan portfolio);

(c) Credit unions that have a history of primarily making member business loans, meaning that either member business loans comprise at least 25% of the credit union's outstanding loans (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements) or member business loans comprise the largest portion of the credit union's loan portfolio (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements). For example, if a credit union makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans, and 13%

total other real estate loans, then the credit union meets this exception.

§ 723.18 How do I obtain an exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state supervisory authority. The state supervisory authority will forward its decision to NCUA. The exception does not expire unless revoked by the state supervisory authority for a state chartered federally insured credit union or the Regional Director for a federal credit union. If an exception request is denied for a federal credit union, it may be appealed to the NCUA Board within 60 days of the denial by the Regional Director. Until the NCUA Board acts on the appeal, the credit union can continue to make new member business loans.

§ 723.19 What are the recordkeeping requirements?

You must separately identify member business loans in your records and in the aggregate on your financial reports.

§ 723.20 How can a state supervisory authority develop and enforce a member business loan regulation?

(a) The NCUA Board may exempt federally insured state chartered credit unions in a given state from NCUA's member business loan rule if NCUA approves the state's rule for use for state chartered federally insured credit unions. In making this determination, the Board is guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business loan rule in this part. Specifically, the Board will focus its review on:

(1) The definition of a member business loan;

(2) Loan to one borrower limits;

(3) Written loan policies;

(4) Collateral and security requirements;

(5) Construction and development lending; and

(6) Loans to senior management.

(b) To receive NCUA's approval of a state's members business loan rule, the state supervisory authority must submit its rule to the NCUA regional office. After reviewing the rule, the region will forward the request to the NCUA Board for a final determination.

§ 723.21 Definitions.

For purposes of this part, the following definitions apply:

Associated member is any member with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower.

Construction or development loan is a financing arrangement for acquiring property or rights to property, including land or structures, with the intent to convert it to income-producing property such as residential housing for rental or sale; commercial use; industrial use; or similar uses.

Immediate family member is a spouse or other family member living in the same household.

Loan-to-value ratio is the aggregate amount of all sums borrowed including outstanding balances plus any unfunded commitment or line of credit from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

Net member business loan balance means the outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien in the member's primary residence, or insured or guaranteed by any agency of the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

Net worth is retained earnings as defined under Generally Accepted Accounting Principles. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities.

Part 724

Trustees and Custodians of Pension Plans

§ 724.1 Federal credit unions acting as trustees and custodians of pension and retirement plans.

A federal credit union is authorized to act as trustee or custodian, and may receive reasonable compensation for so acting, under any written trust instrument or custodial agreement created or organized in the United States and forming part of a pension or profit-sharing plan which qualifies or qualified for specific tax treatment under sections 401(d), 408, 408A and 530 of the Internal Revenue Code (26 U.S.C. 401(d), 408, 408A and 530), for its members or groups of members, provided the funds of such plans are invested in share accounts or share certificate accounts of the federal credit union. Federal credit unions located in a territory, including the trust territories, or a possession of the United States, or the Commonwealth of Puerto Rico, are also authorized to act as trustee or custodian for such plans, if authorized under sections 401(d), 408, 408A and 530 of the Internal Revenue Code as applied to the territory or possession or under similar provisions of territorial law. All funds held in a trustee or custodial capacity must be maintained in accordance with applicable laws and rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other authority exercising jurisdiction over such trust or custodial accounts. The Federal credit union shall maintain individual records for each participant which show in detail all transactions relating to the funds of each participant or beneficiary.

§ 724.2 Self-Directed Retirement Plans.

A Federal credit union may act as trustee or custodian of individual retirement plans of its members established pursuant to section 401(d) or 408 of the Internal Revenue Code, and may facilitate transfers of plan funds to assets other than share and share certificates of the credit union, provided the conditions of Section 724.1 and the following additional conditions are met:

(a) all contributions of funds are initially made to a share or share certificate account in the Federal credit union;

(b) any subsequent transfer of funds to other assets is solely at the direction of the member and the Federal credit union exercises no investment discretion and provides no investment advice with respect to plan assets (i.e., the credit union performs only custodial duties); and

(c) the member is clearly notified of the fact that National Credit Union Share Insurance Fund coverage is limited to funds held in share or share certificate accounts of NCUSIF-insured credit unions.

§ 724.3 Appointment of Successor Trustee or Custodian.

Any plan operated pursuant to this Part shall provide for the appointment of a successor trustee or custodian by a person, committee, corporation, or organization other than the Federal credit union or any person acting in his capacity as a director, employee or agent of the Federal credit union upon notice from the Federal credit union or the Board that the Federal credit union is unwilling or unable to continue to act as trustee or custodian.

Part 725

Central Liquidity Facility

§ 725.1 Scope.

This Part contains the regulations implementing the National Credit Union Central Liquidity Facility Act, Subchapter III of the Federal Credit Union Act. The National Credit Union Administration Central Liquidity Facility is a mixed-ownership Government corporation within the National Credit Union Administration. It is managed by the National Credit Union Administration Board and is owned by its member credit unions. The purpose of the Facility is to improve the general financial stability of credit unions by meeting their liquidity needs and thereby encourage savings, support consumer and mortgage lending and provide basic financial resources to all segments of the economy.

§ 725.2 Definitions.

As used in this Part:

(a) "Agent" means an Agent member of the Facility.

(b) "Agent group" means an Agent member of the Facility consisting of a group of central credit unions, one of which is designated as the group's "Agent group representative" and authorized to transact business with the Facility on behalf of the group or any member of the group.

(c) "Agent loan" means an advance of funds by an Agent to a member natural person credit union to meet liquidity needs which have been the basis for a Facility advance.

(d) "Central credit union" means a Federal or state-chartered credit union primarily serving other credit unions. A credit union is primarily serving other credit unions when the total dollar amount of the shares and deposits received from other credit unions plus loans to other credit unions exceeds 50 percent of the total dollar amount of all shares and deposits plus loans during the qualifying period, as defined in subsection (p) of this section.

(e) "Facility" or "Central Liquidity Facility" means the National Credit Union Administration Central Liquidity Facility.

(f) "Facility advance" means an advance of funds by the Facility to a Regular or Agent member.

(g) "Facility lending officer" means any employee of the Facility or the National Credit Union Administration who has been designated by the NCUA Board as a Facility lending officer.

(h) "Liquid assets" means the following unpledged assets:

(1) cash on hand;

(2) share or deposit accounts with remaining maturities of one year or less maintained in central credit unions or institutions insured by the Federal Deposit Insurance Corporation or Federal Savings and Loan Insurance Corporation;

(3) investments in obligations of the United States or any agency thereof, or securities fully guaranteed as to principal and interest thereby, which are authorized under 12 U.S.C. § 1757(7) and which have a remaining maturity of one year or less;

(4) common trust investments and similar investments in funds or securities authorized for Federal credit unions, the objectives of which are to provide daily liquidity for participating credit unions;

(5) shares in the National Credit Union Administration Central Liquidity Facility or in special share accounts authorized by Section 725.7 of this Part;

(6) in the case of a federally-insured state-chartered credit union, any asset held in satisfaction of liquidity requirements imposed by applicable state law or regulation; and

(7) balances maintained by federally-insured credit unions in a Federal Reserve bank, or in a pass-through account to a Federal Reserve bank, pursuant to the requirements of Section 19(b) of the Federal Reserve Act (12 U.S.C. § 461(b)).

(i) "Liquidity needs" means the needs of credit unions primarily serving natural persons for:

(1) short-term adjustment credit available to assist in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of credit union assets and liabilities;

(2) seasonal credit available for longer periods to assist in meeting seasonal needs for

funds arising from a combination of expected patterns of movement in share and deposit accounts and loans; and

(3) protracted adjustment credit available in the event of unusual or emergency circumstances of a longer term nature resulting from national, regional or local difficulties.

(j) "Management policies" means policies of a credit union with respect to membership, shares, deposits, dividends, interest rates, lending, investing, borrowing, safeguarding of assets, hiring, training and supervision of employees, and general operating and control practices and procedures.

(k) "Member" means a Regular or Agent member of the Facility, unless the context indicates otherwise.

(l) "Member natural person credit union" means a natural person credit union which is a member of an Agent or of any central credit union in an Agent group. Member natural person credit unions are not members of the Facility unless they are also Regular members of the Facility.

(m) "Natural person credit union" means a Federal or state-chartered credit union primarily serving natural persons. A credit union is primarily serving natural persons if it is not a central credit union as defined in subsection (d) of this section.

(n) "NCUA Board" or "Board" means the National Credit Union Administration Board.

(o) *Paid-in and unimpaired capital and surplus* means shares and deposits plus post-closing, undivided earnings. This does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer.

(p) "Qualifying Period" means:

(1) for initial qualification, any 7 months out of the 12 months immediately preceding the month in which application is made to become a member of the Facility; and

(2) for qualification during each subsequent calendar year, any 7 months out of the previous calendar year.

(q) "Stock subscription" means the stock subscription required for membership in the Facility. "Total subscribed Facility stock" is the sum of all members' stock subscriptions.

§ 725.3 Regular Membership.

(a) A natural person credit union may become a Regular member of the Facility by:

(1) making application on a form approved by the Facility;

(2) subscribing to capital stock of the Facility in an amount equal to one-half of 1 percent of the credit union's paid-in and unimpaired capital and surplus, as determined in accordance with subsection 725.5(b) of this Part, and forwarding with its completed application funds equal to one-half of this stock subscription;[1] and

(3) furnishing the following reports and documents with the completed membership application;

(i) a copy of the credit union's financial and statistical report for the most recent calendar month; and

(ii) copies of the credit union's charter and bylaws, unless the credit union is federally chartered.

(b) A credit union which becomes a Regular member of the Facility after February 23, 1980, may not receive Facility advances without approval of the NCUA Board for a period of six months after becoming a member. This subsection shall not apply to any credit union which becomes a Regular member of the Facility within six months after such credit union is chartered, or which has had access to Facility funds through an Agent member of the Facility at any time within six months prior to becoming a Regular member of the Facility.

§ 725.4 Agent Membership.

(a) A central credit union or a group of central credit unions may become an Agent member of the Facility by (in the case of a group of central credit unions, each central credit union in the group must do each of the following except for paragraph (a)(2) of this section, which shall be done by the Agent group representative):

[1] A credit union which submits its application for membership prior to October 1, 1979, is not required to forward these funds to the Facility until October 1, 1979.

(1) making application on a form approved by the Facility;

(2) subscribing to the capital stock of the Facility in an amount equal to one-half of 1 percent of the paid-in and unimpaired capital and surplus (as determined in accordance with subsection 725.5(b) of this Part) of all the central credit union's or central credit union group's member natural person credit unions, except those which are Regular members of the Facility or which have access to the Facility through, and are included in the stock subcription of, another Agent.[2] Upon approval of the application, the Agent shall forward funds equal to one-half of this initial stock subscription to the Facility;[3]

(3) furnishing the following reports and documents with the completed membership application:

(i) a copy of the central credit union's financial and statistical report for the most recent calendar month;

(ii) copies of the central credit union's charter and bylaws, unless such credit union is federally chartered; and

(iii) a list of all the central credit union's member natural person credit unions.

(4) agreeing to submit to the supervision of the NCUA Board and to comply with all regulations and reporting requirements which the NCUA Board shall prescribe for Agent members;

(5) agreeing to submit to periodic unrestricted examinations by the NCUA Board or its designee; and

(6) obtaining the written approval of the NCUA Board.

(b) The NCUA Board may approve a central credit union or group of central credit unions as an Agent member of the Facility, provided the NCUA Board is satisfied that such credit union or credit union group meets certain criteria, including but not limited to the following (in the case of a group of central credit unions, each central credit union in the group must meet these criteria):

(1) the management policies are in writing, approved by the central credit union's board of directors, and reviewed annually by such board;

(2) adequate internal controls are in place to assure accurate and timely reporting of transactions and the safeguarding of assets;

(3) the financial condition of the central credit union is sound with adequate reserves for losses;

(4) surety bond coverage provides protection for the central credit union while the central credit union is performing the duties of an Agent member of the Facility;

(5) management has demonstrated its ability to use such techniques as cash flow analysis, budgeting, and projections of sources and uses of funds to manage the affairs of the central credit union efficiently and in conformity with sound business practices; and

(6) there are no practices, procedures, policies, or other factors that would result in discrimination by the central credit union among natural person credit unions or inhibit its ability to act independ- ently in its role as an Agent member of the Facility.

(c) Each Agent, or in the case of an Agent group, each central credit union in the group, must:

(1) maintain records related to Facility activity in conformity with requirements prescribed by the NCUA Board from time to time; and

(2) submit such reports as may be required by the Facility to determine financial soundness, quality and level of service, and conformity with established guidelines and procedures.

(d) Each Agent, or in the case of an Agent group, each central credit union in the group, must have on an annual basis a third party independent audit of its books and records and provide the Facility with copies of the report of such audit. The auditor selected must be recognized by a state or territorial licensing authority as possessing the requisite knowledge and experience to perform audits.

(e) Within 30 days after a natural person credit union becomes a member of a central credit union which is an Agent or a member of an Agent group, the agent, or in the case of an Agent group, the agent group representative, shall subscribe to additional capital stock of the Facility in an amount equal to one-half of 1 percent of such credit union's paid-in and unimpaired capital and surplus, and shall forward funds equal to one-half of this stock subscription to the Facility. This subsection shall

[2] A natural person credit union which is a member of more than one Agent member of the Facility must designate through which Agent it will deal with the Facility, and the designated Agent will be responsible for including the capital and surplus of such credit union in the calculation of its stock subscription.

[3] If the application is approved prior to October 1, 1979, these funds are not required to be forwarded to the Facility until October 1, 1979.

not apply if the natural person credit union is a Regular member of the Facility or has access to the Facility through, and is included in the stock subscription of, another Agent.

(f) A central credit union or group of central credit unions which becomes an Agent member of the Facility after February 23, 1980, may not receive a Facility advance without approval of the NCUA Board for a period of six months after becoming a member. This subsection shall not apply to any central credit union which becomes an Agent member or a member of an Agent group within six months after such credit union has been an Agent or a member of another Agent group.

(g) Agent members will be compensated for the services they perform for the Facility in a manner to be specified by the NCUA Board.

§ 725.5 Capital Stock.

(a) The capital stock of the Facility is divided into nonvoting shares having a par value of $50 each. The Facility issues whole and fractional shares. Shares are issued in book entry form upon receipt of payment for such shares, and cannot be transferred or hypothecated except to the Facility.

(b) The capital stock subscriptions provided for in Sections 725.3 and 725.4 shall be:

(1) based on an arithmetic average of paid-in and unimpaired capital and surplus over the six months preceding application for membership, and

(2) adjusted at the close of each calendar year in accordance with an arithmetic average of paid-in and unimpaired capital and surplus over the twelve months in such calendar year. Payments for adjustments to the capital stock subscription must be received by the Facility no later than March 31 of the following year.

(c) That part of a member's stock subscription which is not paid-in shall be held by the member on call of the NCUA Board and shall be invested in liquid assets.

(d) Any member may at any time purchase additional shares of capital stock in the Facility. Any shares in excess of the member's required paid-in portion of its stock subscription can be redeemed by the member as long as the member maintains investments in other assets sufficient to meet the requirement of paragraph (c) of this section. The member's required paid-in portion of its stock subscription includes one-half of its stock subscription plus any "calls" that may have been issued by the NCUA Board against the "on-call" portion of such stock subscription.

(e) Dividends will be paid on capital stock at such times and rates as are determined by the NCUA Board. The NCUA Board shall declare such dividends no less frequently than annually. All issued (paid for) capital stock shall share in dividend distributions without preference. Payment of dividends will be made by the issuance of capital stock to the member in the amount of the dividend.

§ 725.6 Termination of Membership.

(a) A member of the Facility whose stock subscription constitutes less than 5 percent of total subscribed Facility stock may withdraw from membership in the Facility six months after notifying the NCUA Board in writing of its intention to do so.

(b) A member of the Facility whose stock subscription constitutes 5 percent or more of total subscribed Facility stock may withdraw from membership in the Facility twenty-four months after notifying the NCUA Board in writing of its intention to do so.

(c) The NCUA Board may terminate membership in the Facility if, after the opportunity for a hearing, the NCUA Board determines the member has failed to comply with any provision of the National Credit Union Central Liquidity Facility Act or any regulation issued pursuant thereto. If membership is terminated under this subsection, the credit union will be required to obtain the approval of the NCUA Board before becoming a member of the Facility again. Such approval will be granted only if the NCUA Board is satisfied that the credit union will comply with such Act and regulations.

(d)(1) If membership is terminated under any provision of this section, the terminated member's stock shall be redeemed upon termination. In such event, the Facility may retain any amount owed to the Facility by the member.

(2) When a member natural person credit union withdraws from membership in a central credit union which is an Agent or a member of an Agent group, the stock subscription of the Agent, or in the case of an Agent group, the stock subscription of the Agent group representative, will be adjusted after the waiting period which would apply under subsection (a) or (b) of

this section if the withdrawing credit union were a member of the Facility.

§ 725.7 Special Share Accounts in Federally Chartered Agent Members.

(a) A federally chartered Agent member of the Facility may require its member natural person credit unions to establish and maintain special share accounts in the Agent member to reimburse it for the portion of the Agent's Facility stock subscription which is attributable to the paid-in and unimpaired capital and surplus of each such natural person credit union.

(b) The amount which the Agent member requires each member natural person credit union to maintain in such special share accounts shall be based on a uniform percentage of the paid-in and unimpaired capital and surplus of such credit unions, and shall not exceed the amount of the Agent's stock subscription which is attributable to the capital and surplus of each such credit union. An Agent shall not permit a member to maintain in a special share account any amounts in excess of the required amount.

(c) A natural person credit union that withdraws from membership in an Agent member or that becomes a Regular member of the Facility, shall be entitled to the return of all amounts in its special share account upon withdrawal from membership in the Agent or upon becoming a Regular member, as applicable.

[Sections 725.8 through 725.16 Reserved for future use.]

§ 725.17 Applications for Extensions of Credit.

(a) A Regular member may apply for a Facility advance to meet its liquidity needs by filing an application on a Facility-approved form, or by any other method approved by the Facility.

(b)(1) An Agent member may apply for a Facility advance by filing an application on a Facility-approved form, or by any other method approved by the Facility.[4]

(2) The Agent's application shall be based on the following:

(i) approved applications to the Agent by its member natural person credit unions for pending loans to meet liquidity needs; or

(ii) outstanding loans previously made by the Agent to meet liquidity needs of its member natural person credit unions; or

(iii) such other demonstrable liquidity needs as the NCUA Board may specify.

(3) An Agent shall not submit an application to the Facility based on the liquidity needs of any member natural person credit union which has not agreed to the repayment, security and credit reporting terms prescribed by the Facility for Agent loans;

(4) Any loan to meet liquidity needs which have been or will be the basis for an application by the Agent for a Facility advance must be applied for on an application form approved by the Facility.

(5) Unless approved by the Facility, an Agent shall not submit an application to the Facility based on the liquidity needs of any credit union which became a member natural person credit union of the Agent after February 23, 1980, unless such credit union has been a member natural person credit union of the Agent for six months, was chartered within six months before becoming a member natural person credit union of the Agent, or had access to the Facility either as a Regular member or through another Agent within six months before becoming a member natural person credit union of the Agent.

(c) In emergency circumstances, the applications for extensions of credit required under subsection (a) and paragraphs (b)(1) and (b)(4) of this section may be verbal, but must be confirmed within five working days by an application as required by such subsection or paragraphs.

(d) Applications of Regular and Agent members shall be filed with a Facility lending officer. Each application for credit which is completed and properly filed will be approved or denied within five working days after the receipt.

§ 725.18 Creditworthiness.

(a) Prior to Facility approval of each application of a Regular member for a Facility advance, the Facility shall consider the creditworthiness of such member.

(b) Prior to an Agent's approval of each application of a member natural person credit union for an extension of credit on which an application by the Agent to the Facility will be based, an Agent shall consider the creditworthiness of such member natural person credit union.

(c) Specific characteristics of an uncreditworthy credit union include, but are not limited to, insol-

[4] If the Agent is an Agent group, the application must be filed by the Agent group representative, and any Facility advance will be made to the Agent group representative.

vency as defined by Section 700.1(k) of this Chapter, unsatisfactory practices in extending credit, lower than desirable reserve levels, high expense ratio, failure to repay previous Facility advances as agreed, excessive dependence on borrowed funds, inadequate cash management policies and planning, or any other relevant characteristics creating a less than satisfactory condition. The presence of one or more of these characteristics will not necessarily mean that a credit union will be considered uncreditworthy.

(d) A natural person credit union (whether a Regular member of the Facility or a member natural person credit union) which does not meet the Facility creditworthiness standards may be limited in or denied the use of advances for its liquidity needs.

§ 725.19 Collateral Requirements.

(a) Each Facility advance and each Agent loan shall be secured by a first priority security interest in collateral of the credit union with a net book value at least equal to 110% of all amounts due under the applicable Facility advance or Agent loan, or by guarantee of the National Credit Union Share Insurance Fund.

(b) The Facility may accept as collateral for each Facility advance to a Regular member, a security interest in all assets of the Regular member; provided however, that the value of any assets in which any third party has a perfected security interest that is superior to the security interest of the Facility shall be excluded for purposes of complying with the requirements of paragraph (a) of this section.

(c) The Facility may accept as collateral for each Facility advance to an Agent member, a security interest in the Agent loans for which the Facility advance was made; provided however, that the collateral for such Agent loan meets the requirements of paragraph (a) of this section.

§ 725.20 Repayment, Security and Credit Reporting Agreements; Other Terms and Conditions.

(a) Regular and Agent members, or in the case of an Agent group, the Agent group representative, shall sign the repayment, security and credit reporting agreements prescribed by the Facility, and all Facility advances to Regular and Agent members shall be governed by the terms and conditions of such agreements.

(b) All Agent loans shall be made subject to the repayment, security and credit reporting terms prescribed by the Facility for Agent loans.

(c) Other terms and conditions applicable to Facility advances and Agent loans will be specified in confirmations of credit provided in connection with such advances and loans, and/or in operating circulars of the Facility.

§ 725.21 Modification of Agreements.

The repayment, security, and credit reporting terms under which Facility advances and Agent loans will be made, as provided in section 725.20 of this Part, shall be subject to modification from time to time as the NCUA Board may determine. Any change in such terms shall be published in the FEDERAL REGISTER and shall apply to all advances disbursed by the Facility after the effective date of the change.

§ 725.22 Advances to Insurance Organizations.

(a) In accordance with policies established by the NCUA Board, the Facility may advance funds to a State credit union share or deposit insurance corporation, guaranty credit union, guaranty association, or similar organization. Requests for such advances shall be supported by an application which sets forth and supports the need for the advance.

(b) Advances under subsection (a) shall be subject to the approval of the NCUA Board and shall be made subject to the following terms:

(1) the advance shall be fully secured,

(2) the maturity of the advance shall not exceed 12 months,

(3) the advance shall not be renewable at maturity, and

(4) the funds advanced shall not be relent at an interest rate exceeding that imposed by the Facility

§ 725.23 Other Advances.

(a) The NCUA Board may authorize extensions of credit to members of the Facility for purposes other than liquidity needs if the NCUA Board, the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury concur in a determination that such extensions of credit are in the national economic interest.

(b) Extensions of credit approved under the conditions of paragraph (a) of this section shall be subject to such terms and conditions as shall be established by the NCUA Board.

Part 740

Accuracy of Advertising and Notice of Insured Status

§ 740.0 Scope.

This part applies to all federally insured credit unions. It prescribes the requirements for the official sign insured credit unions must display and the requirements with regard to the official advertising statement insured credit unions must include in their advertisements. It requires that all other kinds of advertisements be accurate. It also establishes requirements for advertisements of excess insurance.

§ 740.1 Definitions.

(a) *Account* or *accounts* as used in this part means share, share certificate or share draft accounts (or their equivalent under state law, as determined by the Board in the case of insured state credit unions) of a member (which includes other credit unions, public units, and nonmembers where permitted under the Act) in a credit union of a type approved by the Board which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member.

(b) *Insured credit union* as used in this part means a credit union insured by the National Credit Union Administration (NCUA).

§ 740.2 Accuracy of advertising.

No insured credit union may use any advertising (which includes print, electronic, or broadcast media, displays and signs, stationery, and other promotional material) or make any representation which is inaccurate or deceptive in any particular, or which in any way misrepresents its services, contracts, or financial condition, or which violates the requirements of § 707.8 of this subchapter, if applicable. This provision does not prohibit an insured credit union from using a trade name or a name other than its official charter name in advertising or signage, so long as it uses its official charter name in communications with NCUA and for share certificates or certificates of deposit, signature cards, loan agreements, account statements, checks, drafts and other legal documents.

§ 740.3 Advertising of excess insurance.

Any advertising that mentions share or savings account insurance provided by a party other than the NCUA must clearly explain the type and amount of such insurance and the identity of the carrier and must avoid any statement or implication that the carrier is affiliated with the NCUA or the federal government.

§ 740.4 Requirements for the official sign.

(a) Each insured credit union must continuously display the official sign described in paragraph (b) of this section at each station or window where insured account funds or deposits are normally received in its principal place of business and in all its branches, 30 days after its first day of operation as an insured credit union. Each insured credit union must also display the official sign on its Internet page, if any, where it accepts deposits or open accounts, but it may vary the font sizes from that depicted in paragraph (b) of this section to ensure its legibility.

(b) The official sign shall be as depicted below:

Your savings federally insured to $100,000

NCUA

National Credit Union Administration, a U. S. Government Agency

(1) NCUA will automatically supply all insured credit unions an initial supply of official signs with a blue background and white letter-

ing at no cost for compliance with paragraph (a) of this section. If the initial supply is not adequate, the insured credit unions must immediately request additional signs from NCUA. Any credit union that does not have an adequate supply but requests additional signs from NCUA will not be considered to have violated paragraph (a) of this section unless the credit union fails to display the signs after receiving them.

(2) Insured credit unions may purchase additional signs from commercial suppliers in additional colors, materials and sizes, for uses other than those required by paragraph (a) of this section.

(c) An insured credit union must not receive account funds at any teller's station or window where any noninsured credit union or institution receives deposits. Excepted from this prohibition are credit union centers, service centers, or branches servicing more than one credit union where only some of the credit unions are insured by the NCUA. In such instances, immediately above or beside each official sign there must be another sign stating, "Only the following credit unions serviced by this facility are federally insured by the NCUA — " (the full name of each credit union insured will follow the word NCUA). The lettering must be of such size and print to be clearly legible to all members conducting share or share deposit transactions.

(d) The Board may require any insured credit union, upon at least 30 days' written notice, to change the wording of its official signs in a manner deemed necessary for the protection of shareholders or others.

(e) For purposes of this section, the terms "branch," "station," "teller station," and "window" do not include automated teller machines or point of sale terminals.

§ 740.5 Requirements for the official advertising statement.

(a) Each insured credit union must include the official advertising statement, prescribed in paragraph (b) of this section, in all of its advertisements, including on its main Internet page, except as provided in paragraph (c) of this section.

(1) An insured credit union must include the official advertising statement in its advertisements thirty (30) days after its first day of operations as an insured credit union unless the Regional Director grants it an extension.

(2) If advertising copy without the official advertising statement is on hand on the date the requirements of this section become operative, the insured credit union may use an overstamp or other means to include the official advertising statement until the supplies are exhausted.

(b) The official advertising statement is in substance as follows: This credit union is federally insured by the National Credit Union Administration. The short title "Federally insured by NCUA" and a reproduction of the official sign may be used by insured credit unions at their option as the official advertising statement. The official advertising statement must be in a size and print that is clearly legible.

(c) The following advertisements need not include the official advertising statement:

(1) Statements of condition and reports of condition of an insured credit union which are required to be published by state or federal law or regulation;

(2) Credit union supplies such as stationery (except when used for circular letters), envelopes, deposit slips, checks, drafts, signature cards, account passbooks, and noninsurable certificates;

(3) Signs or plates in the credit union office or attached to the building or buildings in which the offices are located;

(4) Listings in directories;

(5) Advertisements not setting forth the name of the insured credit union;

(6) Display advertisements in credit union directories, provided the name of the credit union is listed on any page in the directory with a symbol or other descriptive matter indicating it is insured;

(7) Joint or group advertisements of credit union services where the names of insured credit unions and noninsured credit unions are listed and form a part of such advertisement;

(8) Advertisements by radio that do not exceed thirty (30) seconds in time;

(9) Advertisements by television, other than display advertisements, that do not exceed thirty (30) seconds in time;

(10) Advertisements that because of their type or character would be impractical to include the official advertising statement, including but not limited to, promotional items such as calendars, matchbooks, pens, pencils, and key chains;

(11) Advertisements that contain a statement to the effect that the credit union is insured by the National Credit Union Administration, or that its accounts and shares or members are insured by the Administration to the maximum of $100,000 for each member or shareholder;

(12) Advertisements that do not relate to member accounts, including but not limited to advertisements relating to loans by the credit union, safekeeping box business or services, traveler's checks on which the credit union is not primarily liable, and credit life or disability insurance.

(d) The non-English equivalent of the official advertising statement may be used in any advertisement provided that the Regional Director gives prior approval to the translation.

Part 741

Requirements for Insurance

§ 741.0 Scope.

The provisions of this part apply to federal credit unions, federally insured state-chartered credit unions, and credit unions making application for insurance of accounts pursuant to Title II of the Act, unless the context of a provision indicates its application is otherwise limited. This part prescribes various requirements for obtaining and maintaining federal insurance and the payment of insurance premiums and capitalization deposit. Subpart A of this part contains substantive requirements that are not codified elsewhere in this chapter. Subpart B of this part lists additional regulations, set forth elsewhere in this chapter as applying to federal credit unions, that also apply to federally insured state-chartered credit unions. As used in this part, "insured credit union" means a credit union whose accounts are insured by the National Credit Union Share Insurance Fund (NCUSIF).

Subpart A—Regulations that Apply to Both Federal Credit Unions and Federally Insured State-Chartered Credit Unions and That are not Codified Elsewhere in NCUA's Regulations

§ 741.1 Examination.

As provided in Sections 201 and 204 of the Act (12 U.S.C. 1781 and 1784), the NCUA Board is authorized to examine any insured credit union or any credit union making application for insurance of its accounts. Such examination may require access to all records, reports, contracts to which the credit union is a party, and information concerning the affairs of the credit union. Upon request, such documentation must be provided to the NCUA Board or its representative. Any credit union which makes application for insurance will be required to pay the cost of such examination and processing. To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

§ 741.2 Maximum borrowing authority.

Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act, or any insured credit union, must not borrow, from any source, an aggregate amount in excess of 50 per centum of its paid-in and unimpaired capital and surplus (shares and undivided earnings, plus net income or minus net loss).

§ 741.3 Criteria.

In determining the insurability of a credit union which makes application for insurance and in continuing the insurability of its accounts pursuant to Title II of the Act, the following criteria shall be applied:

(a) *Reserves*—(1) *General rule.* State-chartered credit unions are subject to section 216 of the Act, 12 U.S.C. 1790d, and to part 702 and subpart L of part 747 of this chapter.

(2) *Special reserve for nonconforming investments.* State-chartered credit unions (except state-chartered corporate credit unions) are required to establish an additional special reserve for investments if those credit unions are permitted by their respective state laws to make investments beyond those authorized in the Act or the NCUA Rules and Regulations. For any investment other than loans to members and obligations or securities expressly authorized in Title I of the Act and part 703 of this chapter, as amended, state-chartered credit unions (except state-chartered corporate credit unions) are required to establish and maintain at the end of each accounting period and prior to payment of any dividend, an Appropriation for Non-conforming Investments in an amount at least equal to the net excess of book value over current market value of the investments. If the market value cannot be determined, an amount equal to the full book value will be established. When at the end of any dividend period, the amount in the Appropriation for Non-conforming Investments exceeds the dif-

ference between book value and market value, the board of directors may authorize the transfer of the excess to Undivided Earnings.

(b) *Financial condition and policies.* The following factors are to be considered in determining whether the credit union's financial condition and policies are both safe and sound:

(1) The existence of unfavorable trends which may include excessive losses on loans (i.e., losses which exceed the regular reserve or its equivalent [in the case of state-chartered credit unions] plus other irrevocable reserves established as a contingency against losses on loans), the presence of special reserve accounts used specifically for charging off loan balances of deceased borrowers, and an expense ratio so high that the required transfers to reserves create a net operating loss for the period or that the net gain after these transfers is not sufficient to permit the payment of a nominal dividend;

(2) The existence of written lending policies, including adequate documentation of secured loans and the protection of security interests by recording, bond, insurance, or other adequate means, adequate determination of the financial capacity of borrowers and co-makers for repayment of the loan, and adequate determination of value of security on loans to ascertain that said security is adequate to repay the loan in the event of default;

(3) Investment policies which are within the provisions of applicable law and regulations, i.e., the Act and part 703 of this chapter for federal credit unions and the laws of the state in which the credit union operates for state-chartered credit unions, except state-chartered corporate credit unions. State-chartered corporate credit unions are permitted to make only those investments that are in conformance with part 704 of this chapter and applicable state laws and regulations;

(4) The presence of any account or security, the form of which has not been approved by the Board, except for accounts authorized by state law for state-chartered credit unions.

(c) *Fitness of management.* The officers, directors, and committee members of the credit union must have conducted its operations in accordance with provisions of applicable law, regulations, its charter and bylaws. No person shall serve as a director, officer, committee member, or employee of an insured credit union who has been convicted of any criminal offense involving dishonesty or breach of trust, except with the written consent of the Board.

(d) *Insurance of member accounts would not otherwise involve undue risk to the NCUSIF.* The credit union must maintain adequate fidelity bond coverage as specified in § 741.201. Any circumstances which may be unique to the particular credit union concerned shall also be considered in arriving at the determination of whether or not an undue risk to the NCUSIF is or may be present. For purposes of this section, the term "undue risk to the NCUSIF" is defined as a condition which creates a probability of loss in excess of that normally found in a credit union and which indicates a reasonably foreseeable probability of the credit union becoming insolvent because of such condition, with a resultant claim against the NCUSIF.

(e) *Powers and purposes.* The credit union must not perform services other than those which are consistent with the promotion of thrift and the creation of a source of credit for its members, except as otherwise permitted by law or regulation.

(f) *Letter of disapproval.* A credit union whose application for share insurance is disapproved shall receive a letter indicating the reasons for such disapproval, a citation of the authority for such disapproval, and suggested methods by which the applying credit union may correct its deficiencies and thereby qualify for share insurance.

(g) Nothing in this section shall preclude the NCUA Board from imposing additional terms or conditions pursuant to the insurance agreement.

§ 741.4 Insurance premium and one percent deposit.

(a) *Scope.* This section implements the requirements of Section 202 of the Act (12 U.S.C. 1782) providing for capitalization of the NCUSIF through the maintenance of a deposit by each insured credit union in an amount equaling one percent of its insured shares and payment of an insurance premium.

(b) *Definitions.* For purposes of this section:

(1) *Available assets ratio* means the ratio of:

(i) The amount determined by subtracting all liabilities of the NCUSIF, including contingent liabilities for which no provision for losses has been made, from the sum of cash and the market value of unencumbered investments authorized under 12 U.S.C. 1783(c), to:

(ii) The aggregate amount of the insured shares in all insured credit unions.

(iii) Shown as an abbreviated mathematical formula, the available assets ratio is:

$$\frac{\text{(cash + market value of unencumbered investments) – (liabilities + contingent liabilities for which no provision for losses has been made)}}{\text{aggregate amount of all insured shares from final reporting period of calendar year}}$$

(2) *Equity ratio* means the ratio of:

(i) The amount of NCUSIF's capitalization, meaning insured credit unions' one percent capitalization deposits plus the retained earnings balance of the NCUSIF (less contingent liabilities for which no provision for losses has been made) to:

(ii) The aggregate amount of the insured shares in all insured credit unions.

(iii) Shown as an abbreviated mathematical formula, the equity ratio is:

$$\frac{\text{insured credit unions' 1.0\% capitalization deposits + (NCUSIF's retained earnings – contingent liabilities for which no provision for losses has been made)}}{\text{aggregate amount of all insured shares}}$$

(3) *Insured shares* means the total amount of a credit union's share, share draft and share certificate accounts, or their equivalent under state law (which may include deposit accounts), authorized to be issued to members, other credit unions, public units, or nonmembers (where permitted under the Act or equivalent state law). "Insured shares" does not include amounts in excess of insurance coverage as provided in part 745 of this chapter; and

(4) *Normal operating level* means an equity ratio not less than 1.2 percent and not more than 1.5 percent, as established by action of the NCUA Board.

(5) *Reporting period* means calendar year for credit unions with total assets of less than $50,000,000 and means semiannual period for credit union with total assets of $50,000,000 or more.

(c) *One percent deposit.* Each insured credit union shall maintain with the NCUSIF during each reporting period a deposit in an amount equaling one percent of the total of the credit union's insured shares at the close of the preceding reporting period. For credit unions with total assets of less than $50,000,000, insured shares will be measured and adjusted annually based on the insured shares reported in the credit union's semiannual 5300 report due in January of each year. For credit unions with total assets of $50,000,000 or more, insured shares will be measured and adjusted semiannually based on the insured shares reported in the credit union's quarterly 5300 reports due in January and July of each year.

(d) *Insurance premium charges.* (1) *In general.* Each insured credit union will pay to the NCUSIF, on dates the NCUA Board determines, but not more than twice in any calendar year, an insurance premium in an amount stated as a percentage of insured shares, which will be the same for all insured credit unions.

(2) *Relation of premium charge to equity ratio of NCUSIF.* (i) The NCUA Board may assess a premium charge only if the NCUSIF's equity ratio is less than 1.3 percent and the pre-

mium charge does not exceed the amount necessary to restore the equity ratio to 1.3 percent.

(ii) If the equity ratio of NCUSIF falls below 1.2 percent, the NCUA Board is required to assess a premium in an amount it determines is necessary to restore the equity ratio to, and maintain that ratio at, 1.2 percent.

(e) *Distribution of NCUSIF equity.* If, as of the end of a calendar year, the NCUSIF exceeds its normal operating level and its available assets ratio exceeds 1.0 percent, the NCUA Board will make a proportionate distribution of NCUSIF equity to insured credit unions. The distribution will be the maximum amount possible that does not reduce the NCUSIF's equity ratio below its normal operating level and does not reduce its available assets ratio below 1.0 percent. The distribution will be after the calendar year and in the form determined by the NCUA Board. The form of the distribution may include a waiver of insurance premiums, premium rebates, or distributions from NCUSIF equity in the form of dividends. The NCUA Board will use the aggregate amount of the insured shares from all insured credit unions from the final reporting period of the calendar year in calculating the NCUSIF's equity ratio and available assets ratio for purposes of this paragraph.

(f) *Invoices.* The NCUA provides invoices to all federally insured credit unions stating any change in the amount of a credit union's one percent deposit and the computation and funding of any premium payment due. Invoices for federal credit unions also include any annual operating fees that are due. Invoices are calculated based on a credit union's insured shares as of the most recently ended reporting period. The invoices may also provide for any distribution the NCUA Board declares in accordance with paragraph (e) of this section, resulting in a single net transfer of funds between a credit union and the NCUA.

(g) *New charters.* A newly-chartered credit union that obtains share insurance coverage from the NCUSIF during the calendar year in which it has obtained its charter shall not be required to pay an insurance premium for that calendar year. The credit union shall fund its one percent deposit on a date to be determined by the NCUA Board in the following calendar year, but shall not participate in any distribution from NCUSIF equity related to the period prior to the credit union's funding of its deposit.

(h) *Conversion to Federal insurance.* An existing credit union that converts to insurance coverage with the NCUSIF shall immediately fund its one percent deposit based on the total of its insured shares as of the close of the month prior to conversion and, if any premiums have been assessed in that calendar year, will pay a prorated premium amount to reflect the remaining number of months in that calendar year. The credit union will be entitled to a prorated share of any distribution from NCUSIF equity declared subsequent to the credit union's conversion.

(i) *Mergers of nonfederally insured credit unions.* Where a nonfederally insured credit union merges into a federally insured credit union, the continuing federally insured credit union shall immediately pay to the NCUSIF a prorated insurance premium (unless waived in whole or in part for all federally insured credit unions), and an additional one percent deposit based upon the increase in insured shares resulting from the merger.

(j) *Return of deposit.* Any insolvent credit union that is closed for involuntary liquidation will not be entitled to a return of its deposit. Any solvent credit union that is closed due to involuntary liquidation shall be entitled to a return of its deposit prior to final distribution of member shares. Any other credit union whose insurance coverage with the NCUSIF terminates will be entitled to a return of the full amount of its deposit immediately after the final date on which any shares of the credit union are insured, except that the NCUA Board reserves the right to delay payment by up to one year if it determines that immediate payment would jeopardize the financial condition of the NCUSIF. This includes termination of insurance due to mergers and consolidations. A credit union that receives a return of its deposit during a calendar year shall have the option of leaving a nominal sum on deposit with the NCUSIF until the next distribution from NCUSIF equity and will thus qualify for a prorated share of the distribution.

(k) *Assessment of administrative fee and interest for delinquent payment.* Each federally insured credit union shall pay to the NCUA an administrative fee, the costs of collection, and interest on any delinquent payment of its capitalization deposit or insurance premium. A payment will be considered delinquent if it is postmarked later than the date stated in the invoice provided to the credit union. The NCUA may waive or abate charges or collection of interest, if circumstances warrant.

(1) The administrative fee for a delinquent payment shall be an amount as fixed from time to time by the NCUA Board based upon the

administrative costs of such delinquent payments to the NCUA in the preceding year.

(2) The costs of collection shall be calculated as the actual hours expended by NCUA personnel multiplied by the average hourly cost of the salaries and benefits of such personnel.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and Loan Rate in effect on the date when the payment is due as provided in 31 U.S.C. 3717.

§ 741.5 Notice of termination of excess insurance coverage.

In the event of a credit union's termination of share insurance coverage other than that provided by the NCUSIF, the credit union must notify all members in writing of such termination at least thirty days prior to the effective date of termination.

§ 741.6 Financial and statistical and other reports.

(a) Each operating insured credit union must file with the NCUA a quarterly Financial and Statistical Report on or before January 22 (as of the previous December 31), April 22 (as of the previous March 31), July 22 (as of the previous June 30), and October 22 (as of the previous September 30) of each year. Insured credit unions with assets of $10 million or greater must file all quarterly reports on Form NCUA 5300. Insured credit unions with assets of less than $10 million must file their first (due April 22) and third (due October 22) quarter reports on Form NCUA 5300SF or Form NCUA 5300 and their second (due July 22) and fourth (due January 22) quarter reports on Form NCUA 5300.

(b) *Consistency with GAAP.* The accounts of financial statements and reports required to be filed quarterly under paragraph (a) of this section must reflect GAAP if the credit union has total assets of $10 million or greater, but may reflect regulatory accounting principles other than GAAP if the credit union has total assets of less than $10 million (except that a Federally-insured State-chartered credit union may be required by its state credit union supervisor to follow GAAP regardless of asset size).

(c) *GAAP sources.* GAAP means generally accepted accounting principles, as defined in § 715.2(e) of this chapter. GAAP is distinct from GAAS, which means generally accepted auditing standards, as defined in § 715.2(f) of this chapter. Authoritative sources of GAAP include, but are not limited to, pronouncements of the Financial Accounting Standards Board (FASB) and its predecessor organizations, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA), the FASB's Emerging Issues Task Force (EITF), and the applicable AICPA Audit and Accounting Guide.

(d) Insured credit unions shall, upon written notice from the NCUA Board or Regional Director, file such financial or other reports in accordance with instructions contained in such notice.

§ 741.7 Conversion to a state-chartered credit union.

Any federal credit union that petitions to convert to a state-chartered federally insured credit union is required to apply to the Regional Director for continued insurance of its accounts and meet the requirements as stated in the Act and this part. If the application for continued insurance is not approved, such insurance will terminate subject to the conditions set forth in section 206(d) of the Act.

§ 741.8 Purchase of assets and assumption of liabilities.

(a) Any credit union insured pursuant to Title II of the Act must apply for and receive approval from the NCUA Board before either purchasing or acquiring loans or assuming or receiving an assignment of deposits, shares, or liabilities from:

(1) Any credit union that is not insured pursuant to Title II of the Act;

(2) Any other financial-type institution (including depository institutions, mortgage banks, consumer finance companies, insurance companies, loan brokers, and other loan sellers or liability traders); or

(3) Any successor in interest to any institution identified in paragraph (a)(1) or (a)(2) of this section.

(b) Approval is not required for:

(1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under § 701.23(b)(1) (iii) or (iv) of this chapter or comparable state law for state-chartered credit unions, or purchases of

member loans under § 701.23(b)(1)(i) of this chapter or comparable state law for state-chartered credit unions; or

(2) Assumptions or receipt of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which an NCUSIF-insured credit union perfects a security interest in connection with an extension of credit to any member.

§ 741.9 Uninsured membership shares.

Any credit union that is insured pursuant to Title II of the Act may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to part 745 of this chapter.

§ 741.10 Disclosure of share insurance.

Any credit union which is insured pursuant to Title II of the Act and is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally insured, the credit union shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

§ 741.11 Foreign branching.

(a) *Application and Prior NCUA Approval Required.* Any credit union insured under Title II of the Act must apply for and receive approval from the regional director before establishing a credit union branch outside the United States unless the foreign branch is located on a United States military instillation or embassy outside the United States. The regional director will have 60 days to approve or deny the request.

(b) *Contents of Application.* The application must include a business plan, written approval by the state supervisory agency if the applicant is a state-chartered credit union, and documentation evidencing written permission from the host country to establish the branch that explicitly recognizes NCUA's authority to examine and take any enforcement action, including conservatorship and liquidation actions.

(c) *Contents of Business Plan.* The written business plan must address the following:

(1) Analysis of market conditions in the area where the branch is to be established;

(2) The credit union's plan for addressing foreign currency risk;

(3) Operating facilities, including office space/equipment and supplies;

(4) Safeguarding of assets, bond coverage, insurance coverage, and records preservation;

(5) Written policies regarding the branch (shares, lending, capital, charge-offs, collections);

(6) The field of membership or portion of the field of membership to be served through the foreign branch and the financial needs of the members to be served and services and products to be provided;

(7) Detailed *pro forma* financial statements for branch operations (balance sheet and income and expense projections) for the first and second year including assumptions;

(8) Internal controls including cash disbursal procedures for shares and loans at the branch;

(9) Accounting procedures used to identify branch activity and performance; and

(10) Foreign income taxation and employment law.

(d) *Revocation of Approval.* A state regulator that revokes approval of the branch office must notify NCUA of the action once it issues the notice of revocation. The regional director may revoke approval of the branch office for failure to follow the business plan in a material respect or for substantive and documented safety and soundness reasons. If the regional director revokes the approval, the credit union will have six months from the date of the revocation letter to terminate the operations of the branch. The credit union can appeal this revocation directly to the NCUA Board within 30 days of the date of the revocation letter.

(e) *Insurance Coverage.* Accounts at foreign branches are insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the terms of the account agreement, at a U.S. office

of the credit union. If the host country requires insurance from its own system, accounts will not be insured by the National Credit Union Share Insurance Fund.

Subpart B—Regulations Codified Elsewhere in NCUA's Regulations as Applying to Federal Credit Unions That Also Apply to Federally Insured State-Chartered Credit Unions

§ 741.201 Minimum fidelity bond requirements.

(a) Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act must possess the minimum fidelity bond coverage stated in part 713 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.

(b) Corporate credit unions must comply with § 704.17 of this chapter in lieu of part 713 of this chapter.

§ 741.202 Audit and verification requirements.

(a) The supervisory committee of each credit union insured pursuant to Title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the applicable requirements set forth in part 715 of this chapter or applicable state laws, whichever requirement is more stringent.

(b) Each credit union which is insured pursuant to Title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in § 715.8 of this chapter.

§ 741.203 Minimum loan policy requirements.

Any credit union which is insured pursuant to Title II of the Act must:

(a) Adhere to the requirements stated in part 723 of this chapter concerning member business loans, § 701.21(c)(8) of this chapter concerning prohibited fees, and § 701.21(d)(5) of this chapter concerning nonpreferential loans. State-chartered, NCUSIF-insured credit unions in a given state are exempt from these requirements if the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the member business loan requirements, if the state supervisory authority adopts member business loan regulations that are approved by the NCUA Board pursuant to § 723.20. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and

(b) Adhere to the requirements stated in part 722 of this chapter concerning appraisals.

§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.

Any credit union that is insured, or that makes application for insurance, pursuant to Title II of the Act must:

(a) Adhere to the requirements of § 701.32 of this chapter regarding public unit and nonmember accounts, provided it has the authority to accept such accounts. Requests by federally insured state-chartered credit unions for an exemption from the limitation of § 701.32 of this chapter will be made and reviewed on the same basis as that provided in § 701.32 of this chapter for federal credit unions, provided, however that NCUA will not grant an exemption without the concurrence of the appropriate state regulator.

(b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of the appropriate regional director. The designation will be made and reviewed by the state regulator on the same basis as that provided in § 701.34(a) of this chapter for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.

(c) Receive secondary capital accounts only if the credit has a low-income designation pursuant to paragraph (b) of this section, and then only in accordance with the terms and conditions authorized for Federal credit unions pursuant to § 701.34 of this chapter and to the extent not inconsistent with applicable state law and regulation. State chartered federally insured credit unions offering secondary capital accounts must submit the plan required by § 701.34 to both the state supervisory authority and the NCUA Regional Director.

§ 741.205 Reporting requirements for credit unions that are newly chartered or in troubled condition.

Any federally insured credit union chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in § 701.14(b)(3) of this chapter must adhere to the requirements stated in § 701.14(c) of this chapter concerning the prior notice and NCUA review. Federally insured state-chartered credit unions must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination pursuant to § 701.14 (d)(2) and (f) of this chapter. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual pursuant to § 701.14(d)(1) of this chapter.

§ 741.206 Corporate credit unions.

Any corporate credit union insured pursuant to Title II of the Act shall adhere to the requirements of part 704 of this chapter.

§ 741.207 Community development revolving loan program for credit unions.

Any credit union which is insured pursuant to Title II of the Act and is a "participating credit union," as defined in § 705.3 of this chapter, shall adhere to the requirements stated in part 705 of this chapter.

§ 741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.

Any credit union which is insured pursuant to Title II of the Act and which merges with another credit union or non-credit union institution, and any state-chartered credit union which voluntarily terminates its status as a federally-insured credit union, or converts from federal insurance to other insurance from a government or private source authorized to insure member accounts, shall adhere to the applicable requirements stated in section 206 of the Act and parts 708a and 708b of this chapter concerning mergers and voluntary termination or conversion of insured status.

§ 741.209 Management official interlocks.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 711 of this chapter concerning management official interlocks, issued under the provisions of the Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.).

§ 741.210 Central liquidity facility.

Any credit union which is insured pursuant to Title II of the Act and is a member of the Central Liquidity Facility, shall adhere to the requirements stated in part 725 of this chapter.

§ 741.211 Advertising.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements prescribed by part 740 of this chapter.

§ 741.212 Share insurance.

(a) Member share accounts received by any credit union which is insured pursuant to Title II of

the Act in its usual course of business, including regular shares, share certificates, and share draft accounts, are insured subject to the limitations and rules in subpart A of part 745 of this chapter.

(b) The payment of share insurance and the appeal process applicable to any credit union which is insured pursuant to Title II of the Act are addressed in subpart B of part 745 of this chapter.

§ 741.213 Administrative actions, adjudicative hearings, rules of practice and procedure.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable rules of practice and procedures for administrative actions and adjudicative hearings prescribed by part 747 of this chapter. Subpart E of part 747 of this chapter applies only to federal credit unions.

§ 741.214 Report of crime or catastrophic act and Bank Secrecy Act compliance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 748 of this chapter.

§ 741.215 Records preservation program.

Any credit union which is insured pursuant to Title II of the Act shall maintain a records preservation program as prescribed by part 749 of this chapter.

§ 741.216 Flood insurance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 760 of this chapter.

§ 741.217 Truth in savings.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 707 of this chapter.

§ 741.218 Involuntary liquidation and creditor claims.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable provisions in part 709 of this chapter. Section 709.3 of this chapter applies only to federal credit unions.

§ 741.219 Investment requirements.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 703 of this chapter concerning transacting business with corporate credit unions.

§ 741.220 Privacy of consumer financial information.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 716 of this chapter.

administrative costs of such delinquent payments to the NCUA in the preceding year.

(2) The costs of collection shall be calculated as the actual hours expended by NCUA personnel multiplied by the average hourly cost of the salaries and benefits of such personnel.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and Loan Rate in effect on the date when the payment is due as provided in 31 U.S.C. 3717.

§ 741.5 Notice of termination of excess insurance coverage.

In the event of a credit union's termination of share insurance coverage other than that provided by the NCUSIF, the credit union must notify all members in writing of such termination at least thirty days prior to the effective date of termination.

§ 741.6 Financial and statistical and other reports.

(a) Each operating insured credit union must file with the NCUA a quarterly Financial and Statistical Report on or before January 22 (as of the previous December 31), April 22 (as of the previous March 31), July 22 (as of the previous June 30), and October 22 (as of the previous September 30) of each year. Insured credit unions with assets of $10 million or greater must file all quarterly reports on Form NCUA 5300. Insured credit unions with assets of less than $10 million must file their first (due April 22) and third (due October 22) quarter reports on Form NCUA 5300SF or Form NCUA 5300 and their second (due July 22) and fourth (due January 22) quarter reports on Form NCUA 5300.

(b) *Consistency with GAAP.* The accounts of financial statements and reports required to be filed quarterly under paragraph (a) of this section must reflect GAAP if the credit union has total assets of $10 million or greater, but may reflect regulatory accounting principles other than GAAP if the credit union has total assets of less than $10 million (except that a Federally-insured State-chartered credit union may be required by its state credit union supervisor to follow GAAP regardless of asset size).

(c) *GAAP sources.* GAAP means generally accepted accounting principles, as defined in § 715.2(e) of this chapter. GAAP is distinct from GAAS, which means generally accepted auditing standards, as defined in § 715.2(f) of this chapter. Authoritative sources of GAAP include, but are not limited to, pronouncements of the Financial Accounting Standards Board (FASB) and its predecessor organizations, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA), the FASB's Emerging Issues Task Force (EITF), and the applicable AICPA Audit and Accounting Guide.

(d) Insured credit unions shall, upon written notice from the NCUA Board or Regional Director, file such financial or other reports in accordance with instructions contained in such notice.

§ 741.7 Conversion to a state-chartered credit union.

Any federal credit union that petitions to convert to a state-chartered federally insured credit union is required to apply to the Regional Director for continued insurance of its accounts and meet the requirements as stated in the Act and this part. If the application for continued insurance is not approved, such insurance will terminate subject to the conditions set forth in section 206(d) of the Act.

§ 741.8 Purchase of assets and assumption of liabilities.

(a) Any credit union insured pursuant to Title II of the Act must apply for and receive approval from the NCUA Board before either purchasing or acquiring loans or assuming or receiving an assignment of deposits, shares, or liabilities from:

(1) Any credit union that is not insured pursuant to Title II of the Act;

(2) Any other financial-type institution (including depository institutions, mortgage banks, consumer finance companies, insurance companies, loan brokers, and other loan sellers or liability traders); or

(3) Any successor in interest to any institution identified in paragraph (a)(1) or (a)(2) of this section.

(b) Approval is not required for:

(1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under § 701.23(b)(1) (iii) or (iv) of this chapter or comparable state law for state-chartered credit unions, or purchases of

member loans under § 701.23(b)(1)(i) of this chapter or comparable state law for state-chartered credit unions; or

(2) Assumptions or receipt of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which an NCUSIF-insured credit union perfects a security interest in connection with an extension of credit to any member.

§ 741.9 Uninsured membership shares.

Any credit union that is insured pursuant to Title II of the Act may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to part 745 of this chapter.

§ 741.10 Disclosure of share insurance.

Any credit union which is insured pursuant to Title II of the Act and is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally insured, the credit union shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

§ 741.11 Foreign branching.

(a) *Application and Prior NCUA Approval Required.* Any credit union insured under Title II of the Act must apply for and receive approval from the regional director before establishing a credit union branch outside the United States unless the foreign branch is located on a United States military instillation or embassy outside the United States. The regional director will have 60 days to approve or deny the request.

(b) *Contents of Application.* The application must include a business plan, written approval by the state supervisory agency if the applicant is a state-chartered credit union, and documentation evidencing written permission from the host country to establish the branch that explicitly recognizes NCUA's authority to examine and take any enforcement action, including conservatorship and liquidation actions.

(c) *Contents of Business Plan.* The written business plan must address the following:

(1) Analysis of market conditions in the area where the branch is to be established;

(2) The credit union's plan for addressing foreign currency risk;

(3) Operating facilities, including office space/equipment and supplies;

(4) Safeguarding of assets, bond coverage, insurance coverage, and records preservation;

(5) Written policies regarding the branch (shares, lending, capital, charge-offs, collections);

(6) The field of membership or portion of the field of membership to be served through the foreign branch and the financial needs of the members to be served and services and products to be provided;

(7) Detailed *pro forma* financial statements for branch operations (balance sheet and income and expense projections) for the first and second year including assumptions;

(8) Internal controls including cash disbursal procedures for shares and loans at the branch;

(9) Accounting procedures used to identify branch activity and performance; and

(10) Foreign income taxation and employment law.

(d) *Revocation of Approval.* A state regulator that revokes approval of the branch office must notify NCUA of the action once it issues the notice of revocation. The regional director may revoke approval of the branch office for failure to follow the business plan in a material respect or for substantive and documented safety and soundness reasons. If the regional director revokes the approval, the credit union will have six months from the date of the revocation letter to terminate the operations of the branch. The credit union can appeal this revocation directly to the NCUA Board within 30 days of the date of the revocation letter.

(e) *Insurance Coverage.* Accounts at foreign branches are insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the terms of the account agreement, at a U.S. office

of the credit union. If the host country requires insurance from its own system, accounts will not be insured by the National Credit Union Share Insurance Fund.

Subpart B—Regulations Codified Elsewhere in NCUA's Regulations as Applying to Federal Credit Unions That Also Apply to Federally Insured State-Chartered Credit Unions

§ 741.201 Minimum fidelity bond requirements.

(a) Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act must possess the minimum fidelity bond coverage stated in part 713 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.

(b) Corporate credit unions must comply with § 704.17 of this chapter in lieu of part 713 of this chapter.

§ 741.202 Audit and verification requirements.

(a) The supervisory committee of each credit union insured pursuant to Title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the applicable requirements set forth in part 715 of this chapter or applicable state laws, whichever requirement is more stringent.

(b) Each credit union which is insured pursuant to Title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in § 715.8 of this chapter.

§ 741.203 Minimum loan policy requirements.

Any credit union which is insured pursuant to Title II of the Act must:

(a) Adhere to the requirements stated in part 723 of this chapter concerning member business loans, § 701.21(c)(8) of this chapter concerning prohibited fees, and § 701.21(d)(5) of this chapter concerning nonpreferential loans. State-chartered, NCUSIF-insured credit unions in a given state are exempt from these requirements if the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the member business loan requirements, if the state supervisory authority adopts member business loan regulations that are approved by the NCUA Board pursuant to § 723.20. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and

(b) Adhere to the requirements stated in part 722 of this chapter concerning appraisals.

§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.

Any credit union that is insured, or that makes application for insurance, pursuant to Title II of the Act must:

(a) Adhere to the requirements of § 701.32 of this chapter regarding public unit and nonmember accounts, provided it has the authority to accept such accounts. Requests by federally insured state-chartered credit unions for an exemption from the limitation of § 701.32 of this chapter will be made and reviewed on the same basis as that provided in § 701.32 of this chapter for federal credit unions, provided, however that NCUA will not grant an exemption without the concurrence of the appropriate state regulator.

(b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of the appropriate regional director. The designation will be made and reviewed by the state regulator on the same basis as that provided in § 701.34(a) of this chapter for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.

(c) Receive secondary capital accounts only if the credit has a low-income designation pursuant to paragraph (b) of this section, and then only in accordance with the terms and conditions authorized for Federal credit unions pursuant to § 701.34 of this chapter and to the extent not inconsistent with applicable state law and regulation. State chartered federally insured credit unions offering secondary capital accounts must submit the plan required by § 701.34 to both the state supervisory authority and the NCUA Regional Director.

§ 741.205 Reporting requirements for credit unions that are newly chartered or in troubled condition.

Any federally insured credit union chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in § 701.14(b)(3) of this chapter must adhere to the requirements stated in § 701.14(c) of this chapter concerning the prior notice and NCUA review. Federally insured state-chartered credit unions must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination pursuant to § 701.14 (d)(2) and (f) of this chapter. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual pursuant to § 701.14(d)(1) of this chapter.

§ 741.206 Corporate credit unions.

Any corporate credit union insured pursuant to Title II of the Act shall adhere to the requirements of part 704 of this chapter.

§ 741.207 Community development revolving loan program for credit unions.

Any credit union which is insured pursuant to Title II of the Act and is a "participating credit union," as defined in § 705.3 of this chapter, shall adhere to the requirements stated in part 705 of this chapter.

§ 741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.

Any credit union which is insured pursuant to Title II of the Act and which merges with another credit union or non-credit union institution, and any state-chartered credit union which voluntarily terminates its status as a federally-insured credit union, or converts from federal insurance to other insurance from a government or private source authorized to insure member accounts, shall adhere to the applicable requirements stated in section 206 of the Act and parts 708a and 708b of this chapter concerning mergers and voluntary termination or conversion of insured status.

§ 741.209 Management official interlocks.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 711 of this chapter concerning management official interlocks, issued under the provisions of the Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.).

§ 741.210 Central liquidity facility.

Any credit union which is insured pursuant to Title II of the Act and is a member of the Central Liquidity Facility, shall adhere to the requirements stated in part 725 of this chapter.

§ 741.211 Advertising.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements prescribed by part 740 of this chapter.

§ 741.212 Share insurance.

(a) Member share accounts received by any credit union which is insured pursuant to Title II of

the Act in its usual course of business, including regular shares, share certificates, and share draft accounts, are insured subject to the limitations and rules in subpart A of part 745 of this chapter.

(b) The payment of share insurance and the appeal process applicable to any credit union which is insured pursuant to Title II of the Act are addressed in subpart B of part 745 of this chapter.

§ 741.213 Administrative actions, adjudicative hearings, rules of practice and procedure.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable rules of practice and procedures for administrative actions and adjudicative hearings prescribed by part 747 of this chapter. Subpart E of part 747 of this chapter applies only to federal credit unions.

§ 741.214 Report of crime or catastrophic act and Bank Secrecy Act compliance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 748 of this chapter.

§ 741.215 Records preservation program.

Any credit union which is insured pursuant to Title II of the Act shall maintain a records preservation program as prescribed by part 749 of this chapter.

§ 741.216 Flood insurance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 760 of this chapter.

§ 741.217 Truth in savings.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 707 of this chapter.

§ 741.218 Involuntary liquidation and creditor claims.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable provisions in part 709 of this chapter. Section 709.3 of this chapter applies only to federal credit unions.

§ 741.219 Investment requirements.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 703 of this chapter concerning transacting business with corporate credit unions.

§ 741.220 Privacy of consumer financial information.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 716 of this chapter.

Part 742

Regulatory Flexibility Program

§ 742.1 What is NCUA's Regulatory Flexibility Program?

NCUA's Regulatory Flexibility Program (RegFlex) exempts credit unions with a current net worth of nine percent (or if a credit union is subject to a risk-based net worth requirement under § 702.103 of this chapter, it must be 200 basis points over its risked based net worth level or nine percent, whichever is higher) and a CAMEL rating of 1 or 2, for two consecutive examinations, from all or part of identified NCUA regulations. The Regulatory Flexibility Program also grants eligible credit unions additional powers.

§ 742.2 How do I become eligible for the Regulatory Flexibility Program?

Eligibility is automatic as soon as the credit union meets the net worth and CAMEL criteria. If a credit union is a CAMEL 3 (or CAMEL 1 or 2 for less than two consecutive cycles) with a net worth in excess of 9 percent or if the credit union is a CAMEL 1 or 2 with a net worth under 9 percent (or if a credit union is subject to a risk-based net worth requirement under § 702.103 of this chapter, and it does not exceed 200 basis points over its risk based net worth level), it can apply to the regional director for a RegFlex designation, in whole or in part.

§ 742.3 Will NCUA notify me when I am eligible for the Regulatory Flexibility Program?

Yes. Once this rule is effective, NCUA will notify all RegFlex eligible credit unions. Subsequent notifications of eligibility will occur after an application for a RegFlex designation or as part of the examination process.

§ 742.4 From what NCUA regulations will I be exempt?

(a) RegFlex credit unions are exempt from the provisions of the following NCUA regulations without restrictions or limitations: § 701.25, § 701.32(b) and (c), § 701.36(a), (b) and (c), § 703.5(b)(1)(ii) and (2), § 703.12(c), § 703.16(b), and § 723.7(b) of this chapter.

(b) RegFlex credit unions are exempt from the provisions of the following NCUA regulations with certain restrictions or limitations:

(1) Section 703.13(d)(3) of this chapter, provided the value of the investments that mature later than the borrowing repurchase transaction does not exceed 100 percent of the Federal credit union's net worth; and

(2) Section 703.16(d) of this chapter provided:

(i) The issuer of the security is domestic;

(ii) The security is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization;

(iii) The security meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of commercial mortgage related security as defined in § 703.2 of this chapter;

(iv) The security's underlying pool of loans contains more than 50 loans with no one loan representing more than 10 percent of the pool; and

(v) The aggregate total of commercial mortgage related securities purchased by the Federal credit union does not exceed 50 percent of its net worth.

§ 742.5 What additional authority will I be granted?

Notwithstanding the general limitations in § 701.23 of this chapter, RegFlex credit unions are eligible to purchase any auto loan, credit card loan, member business loan, student loan or mortgage loan from any federally insured credit union as long as the loans are loans that the purchasing credit union is empowered to grant. RegFlex credit unions are authorized to keep these loans in their portfolio. If a RegFlex credit union is purchasing

the eligible obligations of a liquidating credit union, the loans purchased cannot exceed 5% of the unimpaired capital and surplus of the purchasing credit union.

§ 742.6 How can I lose my RegFlex eligibility?

Eligibility may be lost in two ways. First, the credit union no longer meets the RegFlex criteria set forth in § 742.1. When this event occurs, the credit union must cease using the additional authority granted by this rule. Second, the regional director for substantive and documented safety and soundness reasons may revoke a credit union's RegFlex authority in whole or in part. The regional director must give a credit union written notice stating the reasons for this action. The revocation is effective as soon as the regional director's determination has been received by the credit union.

§ 742.7 What is the appeal process?

A credit union has 60 days from the date of the regional director's determination to revoke a credit union's RegFlex authority (in whole or in part) to appeal the action to NCUA's Supervisory Review Committee. The regional director's determination will remain in effect unless the Supervisory Review Committee issues a different determination. If the credit union is dissatisfied with the decision of the Supervisory Review Committee, the credit union has 60 days from the issuance of this decision to appeal to the NCUA Board.

§ 742.8 If I lose my RegFlex authority, will my past actions be grandfathered?

Any action by the credit union under the RegFlex authority will be grandfathered. Any actions subsequent to losing the RegFlex authority must meet NCUA's regulatory requirements. This does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

Part 745

Share Insurance and Appendix

Subpart A—Clarification and Definition of Account Insurance Coverage

§ 745.0 Scope.

The regulation and appendix contained in this Part describe the insurance coverage of various types of member accounts. In general, all types of member share accounts received by the credit union in its usual course of business, including regular shares, share certificates, and share draft accounts, represent equity and are insured. For the purposes of applying the rules in this Part, it is presumed that the owner of funds in an account is an insured credit union member or otherwise eligible to maintain an insured account in a credit union. These rules do not extend insurance coverage to persons not entitled to maintain an insured account or to account relationships that have not been approved by the Board as an insured account. Where there are multiple owners of a single account, generally only that part which is allocable to the member(s) is insured.

§ 745.1 Definitions.

(a) The terms "account" or "accounts" as used in this Part mean share, share certificate or share draft accounts (or their equivalent under state law, as determined by the Board in the case of insured state credit unions) of a member (which includes other credit unions, public units and nonmembers where permitted under the Act) in a credit union of a type approved by the Board which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member.

(b) The terms "member" or "members" as used in this Part mean those persons enumerated in the credit union's field of membership who have been elected to membership in accordance with the Act or state law in the case of state credit unions. It also includes those nonmembers permitted under the Act to maintain accounts in an insured credit union, including nonmember credit unions and nonmember public units and political subdivisions.

(c) The term "public unit" means the United States, any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Panama Canal Zone, any territory or possession of the United States, any county, municipality, or political subdivision thereof, or any Indian tribe as defined in Section 3(c) of the Indian Financing Act of 1974.

(d) The term "political subdivision" includes any subdivision of a public unit, as defined in (c) above, or any principal department of such public unit, (1) the creation of which subdivision or department has been expressly authorized by state statute, (2) to which some functions of government have been delegated by state statute, and (3) to which funds have been allocated by statute or ordinance for its exclusive use and control. It also includes drainage, irrigation, navigation improvement, levee, sanitary, school or power districts and bridge or port authorities, and other special districts created by state statute or compacts between the states. Excluded from the term are subordinate or nonautonomous divisions, agencies, or boards within principal departments.

§ 745.2 General Principles Applicable in Determining Insurance of Accounts.

(a) General: This Part provides for determination by the Board of the amount of members' insured accounts. The rules for determining the insurance coverage of accounts maintained by members in the same or different rights and capacities in the same insured credit union are set forth in the following provisions of this Part. The Appendix provides examples of the application of these rules to various factual situations. While the provisions of this part govern in determining share insurance coverage, to the extent local law enters into a share insurance determination, the local law of the jurisdiction in which the insured credit union's principal office is located will control over the local law of other jurisdictions where the insured credit union has offices or service facilities.

(b) The regulations in this Part in no way are to be interpreted to authorize any type of account that is not authorized by Federal law or regulation or State law or regulation or by the bylaws of a particular credit union. The purpose is to be as inclusive as possible of all situations.

(c) Records: (1) The account records of the insured credit union shall be conclusive as to the existence of any relationship pursuant to which the funds in the account are deposited and on which a claim for insurance coverage is founded. Examples would be trustee, agent, custodian, or executor. No claim for insurance based on such a relationship will be recognized in the absence of such disclosure.

(2) If the account records of an insured credit union disclose the existence of a relationship which may provide a basis for additional insurance, the details of the relationship and the interest of other parties in the account must be ascertainable either from the records of the credit union or the records of the member maintained in good faith and in the regular course of business.

(3) The account records of an insured credit union in connection with a trust account shall disclose the name of both the settlor (grantor) and the trustee of the trust and shall contain an account signature card executed by the trustee.

(4) The interests of the co-owners of a joint account shall be deemed equal, unless otherwise stated on the insured credit union's records in the case of a tenancy in common.

(d) Valuation of trust interests: (1) Trust interests in the same trust deposited in the same account will be separately insured if the value of the trust interest is capable of determination, without evaluation of contingencies, except for those covered by the present worth tables and rules of calculation for their use set forth in § 20.2031–7 of the Federal Estate Tax Regulations (26 C.F.R. 20.2031–7).

(2) In connection with any trust in which certain trust interests are not capable of evaluation in accordance with the foregoing rule, payment by the Board to the trustee with respect to all such trust interests shall not exceed the basic insured amount of $100,000.

(3) Each trust interest in any trust established by two or more settlors shall be deemed to be derived from each settlor pro rata to his contribution to the trust.

(4) The term "trust interest" means the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, but does not include any interest retained by the settlor.

§ 745.3 Single Ownership Accounts.

(a) Funds owned by an individual and deposited in the manner set forth below shall be added together and insured up to $100,000 in the aggregate.

(1) *Individual accounts.* Funds owned by an individual (or by the husband-wife community of which the individual is a member) and deposited in one or more accounts in the individual's own name shall be insured up to $100,000 in the aggregate.

(2) *Accounts held by agents or nominees.* Funds owned by a principal and deposited in one or more accounts in the name or names of agents or nominees shall be added to any individual account of the principal and insured up to $100,000 in the aggregate.

(3) *Custodial loan accounts.* Loan payments received by a Federal credit union prior to remittance to other parties to whom the loan was sold pursuant to Section 107(13) of the Federal Credit Union Act and Section 701.23 of NCUA's Regulations shall be considered to be funds owned by the borrower and shall be added to any individual accounts of the borrower and insured up to $100,000 in the aggregate.

(b) Funds held by a guardian, custodian, or conservator for the benefit of his ward or for the benefit of a minor under a Uniform Gifts to Minors Act and deposited in one or more accounts in the name of the guardian, custodian, or conservator are insured up to $100,000 in the aggregate, separately from any other accounts of the guardian, custodian, conservator, ward, or minor.

§ 745.4 Revocable trust accounts.

(a) For purposes of this part, the term "revocable trust account" includes a testamentary account, tentative or "Totten" trust account, "payable-on-death" account, or any similar account which evidences an intention that the funds shall pass on the death of the owner of the funds to a named beneficiary.

(b) If the named beneficiary of a revocable trust account is a spouse, child, grandchild, parent, brother or sister of the account owner, the account shall be insured up to $100,000 in the aggregate as to each such beneficiary, separately from any other accounts of the owner or beneficiary, regardless of the membership status of the beneficiary.

(c) If the named beneficiary of a revocable trust account is other than the spouse, child, grandchild,

parent, brother or sister of the account owner, the funds in such account shall be added to any individual accounts of the owner and insured up to $100,000 in the aggregate.

(d) For purposes of this section, the term "child" includes the biological, adopted or step-child of the owner; the term "grandchild" includes the biological, adopted or step-child of any of the owner's children; the term "parent" includes the biological, adoptive or step-parent of the owner; the term "brother" includes a full brother, half brother, brother through adoption or step-brother; and the term "sister" includes a full sister, half sister, sister through adoption or step-sister.

(e) *Living trusts.* Insurance treatment under this section also applies to revocable trust accounts held in connection with a so-called "living trust," meaning a formal trust that an owner creates and retains control over during his or her lifetime. If a named beneficiary in a living trust is a qualifying beneficiary under this section, then the share account held in connection with the living trust may be eligible for share insurance under this section, assuming compliance with all the provisions of this part. If the living trust includes a defeating contingency that relates to a beneficiary's interest in the trust assets, then insurance coverage under this section will not be provided. For purposes of this section, a defeating contingency is defined as a condition that would prevent the beneficiary from acquiring a vested and non-contingent interest in the funds in the share account upon the owner's death.

(f) *Joint revocable trust accounts.* Where an account described in paragraph (a) of this section is established by more than one owner and held for the benefit of others, some or all of whom are within the qualifying degree of kinship, the respective interests of each owner held for the benefit of each qualifying beneficiary will be separately insured up to $100,000. The interest of each co-owner will be deemed equal unless otherwise stated in the share account records of the federally-insured credit union. Interests held for non-qualifying beneficiaries will be added to the individual accounts of the owners. Where a husband and a wife establish a revocable trust account naming themselves as the sole beneficiaries, the account will not be insured according to the provisions of this section, but will instead be insured in accordance with the joint account provisions of § 745.8.

§ 745.5 Accounts Held by Executors or Administrators.

Funds of a decedent held in the name of the decedent or in the name of the executor or administrator of the decedent's estate and deposited in one or more accounts shall be insured up to $100,000 in the aggregate for all such accounts, separately from the individual accounts of the beneficiaries of the estate or of the executor or administrator.

§ 745.6 Accounts Held by a Corporation, Partnership or Unincorporated Association.

Accounts of a corporation, partnership, or unincorporated association engaged in any independent activity shall be insured up to $100,000 in the aggregate. The account of a corporation, partnership, or unincorporated association not engaged in an independent activity shall be deemed to be owned by the person or persons owning such corporation or comprising such partnership or unincorporated association and, for account insurance purposes, the interest of each person in such an account shall be added to any other account individually owned by such person and insured up to $100,000 in the aggregate. For purposes of this section, "independent activity" means an activity other than one directed solely at increasing insurance coverage.

§ 745.7 (Reserved)

§ 745.8 Joint ownership accounts.

(a) *Separate insurance coverage.* Qualifying joint accounts, whether owned as joint tenants with right of survivorship, as tenants by the entireties, as tenants in common, or by husband and wife as community property, shall be insured separately from accounts individually owned by any of the co-owners. The interest of a co-owner in all qualifying joint accounts shall be added together and the total for that co-owner shall be insured up to $100,000.

(b) *Qualifying joint accounts.* A joint account is a qualifying joint account if each of the co-owners has personally signed a membership or account signature card and has a right of withdrawal on the same basis as the other co-owners. The signature requirement does not apply to share certificates, or to any accounts maintained by an agent, nominee, guardian, custodian or conservator on behalf of two or more persons if the records of

the credit union properly reflect that the account is so maintained.

(c) *Failure to qualify.* A joint account that does not meet the requirements for a qualifying joint account shall be treated as owned by the named persons as individuals and the actual ownership interest of each such person in such account shall be added to any other accounts individually owned by such person and insured up to $100,000 in the aggregate. An account will not fail to qualify as a joint account if a joint owner is a minor and applicable state law limits or restricts a minor's withdrawal rights.

(d) *Nonmember joint owners.* A nonmember may become a joint owner with a member on a joint account with right of survivorship. The nonmember's interest in such accounts will be insured in the same manner as the member joint-owner's interest.

§ 745.9–1 Trust Accounts.

(a) For purposes of this section, "trust" refers to an irrevocable trust.

(b) All trust interests (as defined in subsection 745.2(d)(4)), for the same beneficiary, deposited in an account and established pursuant to valid trust agreements created by the same settlor (grantor) shall be added together and insured up to $100,000 in the aggregate, separately from other accounts of the trustee of such trust funds or the settlor or beneficiary of such trust arrangements.

(c) This section applies to trust interests created in Education IRAs established in connection with section 530 of the Internal Revenue Code (26 U.S.C. 530).

§ 745.9–2 IRA/Keogh Accounts.

(a) The present vested ascertainable interest of a participant or designated beneficiary in a trust or custodial account maintained pursuant to a pension or profit-sharing plan described under section 401(d) (Keogh account), section 408(a) (IRA) and section 408A (Roth IRA) of the Internal Revenue Code (26 U.S.C. 401(d), 408(a) and 408A) will be insured up to $100,000 separately from other accounts of the participant or designated beneficiary. For insurance purposes, IRA and Roth IRA accounts will be combined together and insured in the aggregate up to $100,000. A Keogh account will be separately insured from an IRA account, Roth IRA account or, where applicable, aggregated IRA and Roth IRA accounts.

§ 745.9–3 Deferred Compensation Accounts.

Funds deposited by an employer pursuant to a deferred compensation plan (including § 401(K) of the Internal Revenue Code) shall be insured up to $100,000 as to the interest of each plan participant who is a member, separately from other accounts of the participant or employer.

§ 745.10 Public Unit Accounts.

(a) Public funds invested in Federal credit unions and federally-insured state credit unions authorized to accept such investments shall be insured as follows:

(1) Each official custodian of funds of the United States lawfully investing the same in a federally-insured credit union will be separately insured in the amount of:

(i) Up to $100,000 in the aggregate for all share draft accounts; and

(ii) Up to $100,000 in the aggregate for all share certificate and regular share accounts;

(2) Each official custodian of funds of any state of the United States or any county, municipality, or political subdivision thereof lawfully investing the same in a federally-insured credit union in the same state will be separately insured in the amount of:

(i) Up to $100,000 in the aggregate for all share draft accounts; and

(ii) Up to $100,000 in the aggregate for all share certificate and regular share accounts;

(3) Each official custodian of funds of the District of Columbia lawfully investing the same in a federally-insured credit union in the District of Columbia will be separately insured in the amount of:

(i) Up to $100,000 in the aggregate for all share draft accounts; and

(ii) Up to $100,000 in the aggregate for all share certificate and regular share accounts;

(4) Each official custodian of funds of the Commonwealth of Puerto Rico, the Panama Canal Zone, or any territory or possession of the United States, or any county, municipality, or political subdivision thereof lawfully investing the same in a federally-insured credit union in Puerto Rico, the Panama Canal Zone, or any such territory or possession, respectively, will be separately insured in the amount of:

(i) Up to $100,000 in the aggregate for all share draft accounts; and

(ii) Up to $100,000 in the aggregate for all share certificate and regular share accounts;

(5) Each official custodian of tribal funds of any Indian tribe (as defined in section 3(c) of the Indian Financing Act of 1974) or agency thereof lawfully investing the same in a federally-insured credit union will be separately insured in the amount of:

(i) Up to $100,000 in the aggregate for all share draft accounts; and

(ii) Up to $100,000 in the aggregate for all share certificate and regular share accounts;

(b) Each official custodian referred to in paragraphs (a)(2), (3), and (4) of this section lawfully investing such funds in share accounts in a federally-insured credit union outside of their respective jurisdictions shall be separately insured up to $100,000 in the aggregate for all such accounts regardless of whether they are share draft, share certificate or regular share accounts.

(c) For purposes of this section, if the same person is an official custodian of more than one public unit, he shall be separately insured with respect to the public funds held by him for each such unit, but he shall not be separately insured with respect to all public funds of the same public unit by virtue of holding different offices in such unit or by holding such funds for different purposes. Where an officer, agent or employee of a public unit has custody of certain funds which by law or under a bond indenture are required to be set aside to discharge a debt owed to the holders of notes or bonds issued by the public unit, any investment of such funds in an account in a federally-insured credit union will be deemed to be a share account established by a trustee of trust funds of which the noteholders or bondholders are pro rata beneficiaries, and the beneficial interest of each noteholder or bondholder in the share account will be separately insured up to $100,000.

(d) For purposes of this section, "lawfully investing" means pursuant to the statutory or regulatory authority of the custodian or public unit.

§ 745.11 Accounts Evidenced by Negotiable Instruments.

If any insured account obligation of a credit union is evidenced by a negotiable certificate account, negotiable draft, negotiable cashier's or officer's check, negotiable certified check, or negotiable traveler's check or letter of credit, the owner of such account obligation will be recognized for all purposes of a claim for insured accounts to the same extent as if his name and interest were disclosed on the records of the credit union provided the instrument was in fact negotiated to such owner prior to the date of the closing of the credit union. Affirmative proof of such negotiation must be offered in all cases to substantiate the claim.

§ 745.12 Account Obligations for Payment of Items Forwarded for Collection by Depository Institution Acting as Agent.

Where a closed credit union has become obligated for the payment of items forwarded for collection by a depository institution acting solely as agent, the owner of such items will be recognized for all purposes of a claim for insured accounts to the same extent as if his name and interest were disclosed on the records of the credit union when such claim for insured accounts, if otherwise payable, has been established by the execution and delivery of prescribed forms. Such depository institution forwarding such items for the owners thereof will be recognized as agent for such owners for the purpose of making an assignment of the rights of such owners against the closed insured credit union to the Board and for the purpose of receiving payment on behalf of such owners.

§ 745.13 Notification to Members/Shareholders.

Each insured credit union shall provide notice to its members concerning NCUA insurance coverage of member accounts. This may be accomplished by placing either a copy of Part 745 of these rules, the Appendix, or one or more copies of the NCUA brochure "Your Insured Funds" in each branch office and main office of the credit union. Copies of these materials shall also be made available to members upon request. For purposes of this section, an automated teller machine or point of sale terminal is not a branch office.

APPENDIX TO PART 745—EXAMPLES OF INSURANCE COVERAGE AFFORDED ACCOUNTS IN CREDIT UNIONS INSURED BY THE NATIONAL CREDIT UNION SHARE INSURANCE FUND

What is the Purpose of this Appendix?

The following examples illustrate insurance coverage on accounts maintained in the same federally-insured credit union. They are intended to cover various types of ownership interests and combinations of accounts which may occur in connection with funds invested in insured credit unions. These examples interpret the rules for insurance of accounts contained in 12 C.F.R. Part 745.

The examples, as well as the rules which they interpret, are predicated upon the assumption that, (1) invested funds are actually owned in the manner indicated on the credit union's records and (2) the owner of funds in an account is a credit union member or otherwise eligible to maintain an insured account in a credit union. If available evidence shows that ownership is different from that on the institution's records, the National Credit Union Share Insurance Fund may pay claims for insured accounts on the basis of actual rather than ostensible ownership. Further, the examples and the rules which they interpret do not extend insurance coverage to persons otherwise not entitled to maintain an insured account or to account relationships that have not been approved by the Board as an insured account.

A. How are Single Ownership Accounts Insured?

All funds owned by an individual member (or, in a community property state, by the husband-wife community of which the individual is a member) and invested in one or more individual accounts are added together and insured to the $100,000 maximum. This is true whether the accounts are maintained in the name of the individual member owning the funds, in the name of the member's agent or nominee, or in a custodial loan account on behalf of the member as a borrower. (§§ 745.3(a)(1), (2) and (3).) All such accounts are added together and insured as one individual account. Funds held in one or more accounts in the name of a guardian, custodian, or conservator for the benefit of a ward or minor are added together and insured up to $100,000. However, such account or accounts will not be added to any other individual accounts of the guardian, custodian, conservator, ward, or minor for purposes of determining insurance coverage. (§ 745.3(b).)

Example 1

Question: Members A and B, husband and wife, each maintain an individual account containing $100,000. In addition, they hold a joint account containing $100,000. What is the insurance coverage?

Answer: Each account is separately insured up to $100,000 for a total coverage of $300,000. The coverage would be the same whether the individual accounts contain funds owned as community property or as individual property of the spouses (§ 745.3(a)(1) and § 745.8(a)).

Example 2

Question: Members H and W, husband and wife, reside in a community property share. H maintains a $100,000 account consisting of his separately-owned funds and invests $100,000 of community property funds in another account, both of which are in his name alone. What is the insurance coverage?

Answer: The two accounts are added together and insured to a total of $100,000. $100,000 is uninsured (§ 745.3(a)(1)).

Example 3

Question: Member A has $92,500 invested in an individual account, and his agent, Member B, invests $25,000 of A's funds in a properly designated agency account. B also holds a $100,000 individual account. What is the insurance coverage?

Answer: A's individual account and the agency account are added together and insured to the $100,000 maximum, leaving $17,500 uninsured. The investment of funds through an agent does not result in additional insurance coverage for the principal (§ 745.3(a)(2)). B's individual account is insured separately from the agency account

(§ 745.3(a)(1)). However, if the account records of the credit union do not show the agency relationship under which the funds in the $25,000 account are held, the $25,000 in B's name could, at the option of the NCUSIF, be added to his individual account and insured to $100,000 in the aggregate, leaving $25,000 uninsured (§ 745.2(c)).

Example 4

Question: Member A holds a $100,000 individual account. Member B holds two accounts in his own name, the first containing $25,000 and the second containing $92,500. In processing the claims for payment of insurance on these accounts, the NCUSIF discovers that the funds in the $25,000 account actually belong to A and that B had invested these funds as agent for A, his undisclosed principal. What is the insurance coverage?

Answer: Since the available evidence shows that A is the actual owner of the funds in the $25,000 account, those funds would be added to the $100,000 individual account held by A (rather than to B's $92,500 account) and insured to the $100,000 maximum, leaving $25,000 uninsured. (§ 745.3(a)(2).) B's $92,500 individual account would be separately insured.

Example 5

Question: Member C, a minor, maintains an individual account of $750. C's grandfather makes a gift to him of $100,000, which is invested in another account by C's father, designated on the credit union's records as custodian under a Uniform Gift to Minors Act. C's father, also a member, maintains an individual account of $100,000. What is the insurance coverage? Answer: C's individual account and the custodian account held for him by his father are each separately insured: the $100,000 maximum on the custodian account, and $750 on his individual account. The individual account held by C's father is also separately insured to the $100,000 maximum. (§§ 745.3(a)(1) and (b).)

Example 6

Question: Member G, a court-appointed guardian, invests in a properly designated account $100,000 of funds in his custody which belong to member W, his ward. W and G each maintain $25,000 individual accounts. What is the insurance coverage?

Answer: W's individual account and the guardianship account in G's name are each insured to $100,000 providing W with $125,000 in insured funds. G's individual account is also separately insured. (§§ 745.3(a)(1) and (b).)

Example 7

Question: X Credit Union acts as a servicer of FHA, VA, and conventional mortgage loans made to its members but sold to other parties. Each month X receives loan payments, for remittance to the other parties, from approximately 2,000 member mortgagors. The monies received each month total $1,000,000 and are maintained in a custodial loan account. What is the insurance coverage?

Answer: X Credit Union acts as custodian for the 2,000 individual mortgagors. The interest of each mortgagor is separately insured as his individual account (but added to any other individual accounts which the mortgagor holds in the Credit Union) (§ 745.3(a)(3)).

B. How are Revocable Trust Accounts Insured?

The term "revocable trust account" includes a testamentary account, tentative or "Totten" trust account, "payable-on-death" account, or any similar account which evidences an intention that the funds shall pass on the death of the owner of the funds to a named beneficiary. If the named beneficiary is a spouse, child, grandchild, parent, brother or sister (as defined in subsection 745.4(d)) of the owner, the funds in all such accounts are insured for the owner up to $100,000 in the aggregate as to each such beneficiary. If the beneficiary of such an account is other than the spouse, child, grandchild, parent, brother or sister of the owner, the funds in the account are, for insurance purposes, added to any other individual (single ownership) accounts of the owner and insured up to $100,000 in the aggregate. In the case of a revocable trust account, the person who holds the power of revocation is deemed to be the owner of the funds in the account. If a revocable trust account is held in the name of a fiduciary other than the owner of the funds, any other accounts held by the fiduciary are insured separately from such revocable trust account.

Example 1

Question: Member H invests $200,000 in a revocable trust account with his son, S, and his daughter, D, as named beneficiaries. What is the insurance coverage?

Answer: Since S and D are children of H, the owner of the account, the funds are insured up to $100,000 as to each beneficiary (§ 745.4(b)). Assuming that S and D have equal beneficial interests ($100,000 each), H is fully insured for this account.

Example 2

Question: Member H invests $100,000 in each of four "payable-on-death" accounts. Under the terms of each account contract, H has the right to withdraw any or all of the funds in the account at any time. Any funds remaining in the account at the time of H's death are to be paid to a named beneficiary. The respective beneficiaries of the four accounts are H's wife, his mother, his brother, and his nephew. H also holds an individual account containing $100,000. What is the insurance coverage?

Answer: The accounts payable on death to H's wife, mother and brother are each separately insured to the $100,000 maximum (Sec. 745.4(b)). The account payable to H's nephew is added to H's individual account and insured to $100,000 in the aggregate, leaving $100,000 uninsured (Sec. 745.4(c)).

Example 3

Question: Members H and W jointly invest in a "payable-on-death" account for the benefit of their son, S, and daughter, D. The account is held by H and W with right of survivorship. What is the maximum insurance coverage available on the account? Answer: Since S and D are the children of H and W, the account will be insured up to $100,000 as to each beneficiary separately from any accounts of the owners, H and W (§ 745.4(b)). H would be entitled to $100,000 insurance for S and $100,000 for D. W would be entitled to the same coverage for a total of $400,000 on the account. However, upon the death of either H or W, insurance coverage would be reduced to $200,000.

Example 4

Question: Member H invests $200,000 in a revocable trust account held in connection with a living trust with his son, S, and his daughter, D, as named beneficiaries. What is the insurance coverage?

Answer: Since S and D are children of H, the owner of the account, the funds would normally be insured under the rules governing revocable trust accounts up to $100,000 as to each beneficiary (§ 745.4(b)). However, because this account is held in connection with a living trust whose named beneficiaries are qualifying beneficiaries under § 745.4, it must be scrutinized to determine whether the account complies with all other provisions of this part and whether the living trust contains any defeating contingencies. Assuming there are no defeating contingencies and that the account complies with all other requirements of this part, then it will be treated as any other revocable trust. In this instance, it will be insured up to $100,000 as to each beneficiary (§ 745.4(e)). Assuming that S and D have equal beneficial interests ($100,000 each), H is fully insured for this account.

C. How are Accounts Held by Executors or Administrators Insured?

All funds belonging to a decedent and invested in one or more accounts, whether held in the name of the decedent or in the name of his executor or administrator, are added together and insured to the $100,000 maximum. Such funds are insured separately from the individual accounts of any of the beneficiaries of the estate or of the executor or administrator.

Example 1

Question: Member A, administrator of Member D's estate, sells D's automobile and invests the proceeds of $12,500 in an account entitled "A Administrator of the estate of D." A has an individual account in that same credit union containing $100,000. Prior to his death, D had opened an individual account of $100,000. What is the insurance coverage?

Answer: The $12,500 is added to D's individual account and insured to $100,000, leaving $12,500 uninsured. A's individual account is separately insured for $100,000 (§ 745.5).

D. How are Accounts Held by a Corporation, Partnership or Unincorporated Association Insured?

All funds invested in an account or accounts by a corporation, a partnership or an unincorporated association engaged in any independent activity are added together and insured to the $100,000 maximum. The term "independent activity" means any activity other than the one directed solely at increasing coverage. If the corporation, partnership or unincorporated association is not engaged in an independent activity, any account held by the entity is insured as if owned by the persons owning or comprising the entity, and the imputed interest of each such person is added for insurance purposes to any individual account which he maintains.

Example 1

Question: Member X Corporation maintains a $100,000 account. The stock of the corporation is owned by members A, B, C, and D in equal shares. Each of these stockholders also maintains an individual account of $100,000 with the same credit union. What is the insurance coverage?

Answer: Each of the five accounts would be separately insured to $100,000 if the corporation is engaged in an independent activity and has not been established merely for the purpose of increasing insurance coverage. The same would be true if the business were operated as a bona fide partnership instead of as a corporation (§ 745.6). However, if X corporation was not engaged in an independent activity, then $25,000 (1/4 interest) would be added to each account of A, B, C, and D. The accounts of A, B, C, and D would then each be insured to $100,000, leaving $25,000 in each account uninsured.

Example 2

Question: Member C College maintains three separate accounts with the same credit union under the titles: "General Operating Fund," "Teachers Salaries," and "Building Fund." What is the insurance coverage?

Answer: Since all of the funds are the property of the college, the three accounts are added together and insured only to the $100,000 maximum (§ 745.6).

Example 3

Question: The men's club of X Church carries on various social activities in addition to holding several fund-raising campaigns for the church each year. The club is supported by membership dues. Both the club and X Church maintain member accounts in the same credit union. What is the insurance coverage?

Answer: The men's club is an unincorporated association engaged in an independent activity. If the club funds are, in fact, legally owned by the club itself and not the church, each account is separately insured to the $100,000 maximum (§ 745.6).

Example 4

Question: The PQR Union, a member of the ABC Federal Credit Union, has three locals in a certain city. Each of the locals maintains an account containing funds belonging to the parent organization. All three accounts are in the same insured credit union. What is the insurance coverage?

Answer: The three accounts are added together and insured up to the $100,000 maximum (§ 745.6).

E. How are Public Unit Accounts Insured?

For insurance purposes, the official custodian of funds belonging to a public unit, rather than the public unit itself, is insured as the account holder. All funds belonging to a public unit and invested by the same custodian in a federally-insured credit union are categorized as either share draft accounts or share certificate and regular share accounts. If these accounts are invested in a federally-insured credit union located in the jurisdiction from which the official custodian derives his authority, then the share draft accounts will be insured separately from the share certificate and regular share accounts. Under this circumstance, all share draft accounts are added together and insured to the $100,000 maximum and all share certificate and regular share accounts are also added together and separately insured up to the $100,000 maximum. If, however, these

accounts are invested in a federally-insured credit union located outside of the jurisdiction from which the official custodian derives his authority, then insurance coverage is limited to $100,000 for all accounts regardless of whether they are share draft, share certificate or regular share accounts. If there is more than one official custodian for the same public unit, the funds invested by each custodian are separately insured. If the same person is custodian of funds for more than one public unit, he is separately insured with respect to the funds of each unit held by him in properly designated accounts.

For insurance purposes, a "political subdivision" is entitled to the same insurance coverage as any other public units. "Political subdivision" includes any subdivision of a public unit or any principal department of such unit (1) the creation of which has been expressly authorized by state statute, (2) to which some functions of government have been allocated by state statute, and (3) to which funds have been allocated by statute or ordinance for its exclusive use and control.

Example 1

Question: As Comptroller of Y Consolidated School District, A maintains a $125,000 account in the credit union containing school district funds. He also maintains his own $100,000 member account in the same credit union. What is the insurance coverage? Answer: The two accounts will be separately insured, assuming the credit union's records indicate that the account containing the school district funds is held by A in a fiduciary capacity. Thus, $100,000 of the school's funds and the entire $100,000 in A's personal account will be insured (§§ 745.10(a)(2) and 745.3).

Example 2

Question: A, as city treasurer, and B, as chief of the city police department, each have $100,000 in city funds invested in custodial accounts. What is the insurance coverage?

Answer: Assuming that both A and B have official custody of the city funds, each account is separately insured to the $100,000 maximum (§ 745.10(a)(2)).

Example 3

Question: A is Treasurer of X County and collects certain tax assessments, a portion of which must be paid to the state under statutory requirement. A maintains an account for general funds which belong to the State Treasurer. The credit union's records indicate that the separate account contains funds held for the State. What is the insurance coverage?

Answer: Since two public units own the funds held by A, the accounts would each be separately insured to the $100,000 maximum (§ 745.10(a)(2)).

Example 4

Question: A city treasurer invests city funds in each of the following accounts: "General Operating Account," "School Transportation Fund," "Local Maintenance Fund," and "Payroll Fund." Each account is available to the custodian upon demand. By administrative direction, the city treasurer has allocated the funds for the use of and control by separate departments of the city. What is the insurance coverage?

Answer: All of the accounts are added together and insured in the aggregate to $100,000. Because the allocation of the city's funds is not by statute or ordinance for the specific use of and control by separate departments of the city, separate insurance coverage to the maximum of $100,000 is not afforded to each account (§§ 745.1(d) and 745.10(a)(2)).

Example 5

Question: A, the custodian of retirement funds of a military exchange, invests $1,000,000 in an account in an insured credit union. The military exchange, a non-appropriated fund instrumentally of the United States, is deemed to be a public unit. The employees of the exchange are the beneficiaries of the retirement funds but are not members of the credit union. What is the insurance coverage?

Answer: Because A invested the funds on behalf of a public unit, in his capacity as custodian, those funds qualify for $100,000 share insurance even though A and the public unit are not within the credit union's field of membership. Since the beneficiaries are neither public units nor members of the credit union they are not entitled to separate share insurance. Therefore, $900,000 is uninsured (§ 745.10(a)(1)).

Example 6

Question: A is the custodian of the County's employee retirement funds. He deposits $1,000,000 in retirement funds in an account in an insured credit union. The "beneficiaries" of the retirement fund are not themselves public units nor are they within the credit union's field of membership. What is the insurance coverage?

Answer: Because A invested the funds on behalf of a public unit, in his capacity as custodian, those funds qualify for $100,000 share insurance even though A and the public unit are not within the credit union's field of membership. Since the beneficiaries are neither public units nor members of the credit union they are not entitled to separate share insurance. Therefore, $900,000 is uninsured (§ 745.10(a)(2)).

Example 7

Question: A county treasurer establishes the following share draft accounts in an insured credit union each with $100,000:

"General Operating Fund"
"County Roads Department Fund"
"County Water District Fund"
"County Public Improvement District Fund"
"County Emergency Fund"

What is the insurance coverage?

Answer: The "County Roads Department," "County Water District" and "County Public Improvement District" accounts would each be separately insured to $100,000 if the funds in each such account have been allocated by law for the exclusive use of a separate county department or subdivision expressly authorized by State statute. Funds in the "General Operating" and "Emergency Fund" accounts would be added together and insured in the aggregate to $100,000, if such funds are for countywide use and not for the exclusive use of any subdivision or principal department of the county, expressly authorized by State statute (§§ 745.1(d) and 745.10(a)(2)).

Example 8

Question: A, the custodian of Indian tribal funds, lawfully invests $1,000,000 in an account in an insured credit union on behalf of 15 different tribes; the records of the credit union show that no tribe's interest exceeds $100,000. A, as official custodian, also invests $1,000,000 in the same credit union on behalf of 100 individual indians, who are not members; each indian's interest is $10,000. What is the insurance coverage?

Answer: Because each tribe is considered a separate public unit, the custodian of each tribe, even though the same person, is entitled to separate insurance for each tribe (§ 745.10(a)(5)). Since the credit union's records indicate no tribe has more than $100,000 in the account, the $1,000,000 would be fully insured as 15 separate tribal accounts. If any one tribe had more than a $100,000 interest in the funds, it would be insured only to $100,000 and any excess would be uninsured. However, the $1,000,000 invested on behalf of the individual indians would not be insured since the individual indians are neither public units nor, in the example, members of the credit union. If A is the custodian of the funds in his capacity as an official of a governmental body that qualified as a public unit, then the account would be insured for $100,000 leaving $900,000 uninsured.

Example 9

Question: A, an official custodian of funds of a state of the United States, lawfully invests $250,000 of state funds in a federally-insured credit union located in the state from which he derives his authority as an official custodian. What is the insurance coverage?

Answer: If A invested the entire $250,000 in a share draft account, then $100,000 would be insured and $150,000 would be uninsured. If A invested $125,000 in share draft accounts and another $125,000 in share certificate and regular share accounts, then A would be insured for $100,000 for the share draft accounts and $100,000 for the share certificate and regular share accounts leaving $50,000 uninsured (§ 745.10(a)(2)). If A had invested the $250,000 in a federally-insured credit union located outside the state from which he derives his authority as an official custodian, then $100,000 would be insured for all accounts regardless of whether they were share draft, share certificate or regular share

accounts, leaving $150,000 uninsured (§ 745.10(b)).

F. How are Joint Accounts Insured?

The interest of a co-owner in all accounts held under any form of joint ownership valid under state law (whether as joint tenants with right of survivorship, tenants by the entireties, tenants in common, or by husband and wife as community property) is insured up to $100,000. This insurance is separate from that afforded individual accounts held by any of the co-owners.

An account is insured as a joint account only if each of the co-owners has personally signed a membership card or an account signature card and possesses the same withdrawal rights as the other co-owners. (The signature requirement does not apply to share certificates, or to any accounts maintained by an agent, nominee, guardian, custodian or conservator on behalf of two or more persons. However, the records of the credit union must show that the account is being maintained for joint owners. There is also another exception in the case of a minor discussed below.) An account owned jointly which does not qualify as a joint account for insurance purposes is insured as if owned by the named persons as individuals. In that case, the actual ownership interest in the account of each person is added to any other accounts individually owned by such person and insured up to $100,000 in the aggregate.

Any individual, including a minor, may be a co-owner of a joint account. Although, generally, each co-owner must have signed an account signature card and must have the same rights of withdrawal as other co-owners in order for the account to qualify for separate joint account insurance, there is an exception for minors. If state law limits or restricts a minor's withdrawal rights—for example, a minimum age requirement to make a withdrawal—the account will still be insured as a joint account.

The interests of a co-owner in all joint accounts that qualify for separate insurance coverage are insured up to the $100,000 maximum. For insurance purposes, the co-owners of any joint account are deemed to have equal interests in the account, except in the case of a tenancy in common. With a tenancy in common, equal interests are presumed unless otherwise stated on the records of the credit union.

Question: Members A and B maintain an account as joint tenants with right of survivorship and, in addition, each holds an individual account. Is each account separately insured?

Answer: If both A and B have signed the membership or signature card and possess equal withdrawal rights with respect to the joint funds, their interests in the joint account are separately insured from their interests in the individual accounts. (§ 745.8 (a) and (b).) If the joint account is represented by a share certificate, their individual signatures are not required for that account.

Example 2

Question: Members H and W, husband and wife, reside in a community property state. Each holds an individual account and, in addition, they hold a qualifying joint account. The funds in all three accounts consist of community property. Is each account separately insured?

Answer: Yes. An account in the individual name of a spouse will be insured up to $100,000 whether the funds consist of community property or separate property of the spouse. A joint account containing community property is separately insured. Thus, community property can be used for individual accounts in the name of each spouse and for a joint account in the name of both spouses. In this example, each individual account is insured up to $100,000 (§ 745.3(a)(1)), and the interests of both the husband and wife in the joint account are each insured up to $100,000 (§ 745.8(a)).

Example 3

Question: Two accounts of $100,000 each are held by a member husband and his wife under the following names: John Doe and Mary Doe, husband and wife, as joint tenants with right of survivorship. Mrs. John Doe and John Q. Doe (community property). How much insurance do the husband and wife have?

Answer: They have $200,000 of insurance. Both the husband and wife are deemed to have a one half interest ($50,000) in each account. (§ 745.2(c)(4).) The husband's interest in both accounts would be added together and insured for $100,000. The wife's insurance coverage would be determined the same way. (§ 745.8(a).)

Example 4

Question: The following accounts are held by members A, B and C, each of whom has personally

executed signature cards for the accounts in which he has an interest. Each co-owner of a joint account possesses the necessary withdrawals rights.

1. A, as an individual—$100,000.
2. B, as an individual—$100,000.
3. C, as an individual—$100,000.
4. A and B, as joint tenants w/r/o survivorship—$90,000.
5. A and C, as joint tenants w/r/o survivorship—$90,000.
6. B and C, as joint tenants w/r/o survivorship—$90,000.
7. A, B and C, as joint tenants w/r/o survivorship—$90,000.

What is the insurance coverage?

Answer: Accounts numbered 1, 2 and 3 are each separately insured for $100,000 as individual accounts held by A, B and C, respectively (§ 745.3(a)(1)). The interest of the co-owners of each joint account are deemed equal for insurance purposes (§ 745.2(c)(4)). A's interest in accounts numbered 4, 5, and 7 are added together for insurance purposes (§ 745.8(e)). Thus, A has an interest of $45,000 in account No. 4, $45,000 in account No. 5 and $30,000 in account No. 7, for a total joint account interest of $120,000, of which $100,000 is insured. The interest of B and C are similarly insured.

Example 5(a)

Question: A, B and C hold accounts as set forth in Example 4. Members A and B are husband and wife; C, their minor child, has failed to sign the signature card for Account No. 7. In Account No. 5, according to the terms of the account, C cannot make a withdrawal without A's written consent. (This is not a limitation imposed under state law.) In Account No. 6, the signatures of both B and C are required for withdrawal. A has provided all of the funds for Accounts numbered 5 and 7 and under state law has the entire actual ownership interest in these two accounts. What is the insurance coverage?

Answer: If any of the co-owners of a joint account have failed to meet any of the joint account requirements, the account is not a qualifying joint account. Instead, the account is treated as if it consisted of commingled individual accounts of each of the co-owners in accordance with his or her actual ownership interest in the funds, as determined under applicable state law. (§ 745.8(c).)

Account No. 5 is not a qualifying joint account because C does not have equal withdrawal rights with A. Based on the terms of the account, C can only make a withdrawal if he has A's written consent. Account No. 7 is not a qualifying joint account because C did not personally sign the signature card. Therefore, all of the funds in Accounts 5 and 7 are treated as individually owned by A and added to A's individual account, Account No. 1. For insurance purposes then, A has $280,000 in one individual account that is insured for $100,000, leaving $180,000 uninsured.

Account 6 is a qualifying joint account for insurance purposes since each co-owner has the right to withdraw funds on the same basis. Account 4 is also a qualifying joint account. A's interest in Account 4 is insured for $45,000. B's interest of $45,000 in Account 4 is added to her interest of $45,000 in Account 6 and insured for $90,000. C's interest in Account 6 is insured for $45,000.

Example 5(b)

Question: Assume the same accounts as Example 5(a) except that, on Account No. 5, C's right to make a withdrawal is limited by state law which precludes a minor from making a withdrawal without the co-owner's written consent. What is the insurance coverage?

Answer: In this situation, Accounts 4, 5, and 6 all qualify as joint accounts. A, B, and C will each have $90,000 of insured funds based on: A's interest in Account 4 ($45,000) and 5 ($45,000), B's interest in Accounts 4 ($45,000) and 6 ($45,000), and C's interest in Accounts 5 ($45,000) and 6 ($45,000). As in Example 5(a), Account No. 7 does not qualify as a joint account and would be added to A's individual account for insurance purposes.

G. How are Trust Accounts and Retirement Accounts Insured?

A trust estate is the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, that is valid under state law. Thus, funds invested in an account by a trustee under an irrevocable express trust are insured on the basis of the beneficial interests under such trust. The interest of each beneficiary in an account (or accounts) established under such a trust arrangement is insured to $100,000 separately from other accounts held by the trustee, the settlor (grantor), or the beneficiary. However, in cases where a beneficiary has an interest in more than one trust arrangement created by the

same settlor, the interests of the beneficiary in all accounts established under such trusts are added together for insurance purposes, and the beneficiary's aggregate interest derived from the same settlor is separately insured to the $100,000 maximum.

A beneficiary's interest in an account established pursuant to an irrevocable express trust arrangement is insured separately from other beneficial interests (trust estates) invested in the same account if the value of the beneficiary's interest (trust estate) can be determined (as of the date of a credit union's insolvency) without evaluation of contingencies except for those covered by the present worth tables and rules of calculation for their use set forth in § 20.2031–10 of the Federal Estate Tax Regulations (26 C.F.R. 20–2031–10). If any trust estates in such an account cannot be so determined, the insurance with respect to all such trust estates together shall not exceed the basic insured amount of $100,000.

In order for insurance coverage of trust accounts to be effective in accordance with the foregoing rules, certain recordkeeping requirements must be met. In connection with each trust account, the credit union's records must indicate the name of both the settlor and the trustee of the trust and must contain an account signature card executed by the trustee indicating the fiduciary capacity of the trustee. In addition, the interests of the beneficiaries under the trust must be ascertainable from the records of either the credit union or the trustee, and the settlor or beneficiary must be a member of the credit union. If there are two or more settlors or beneficiaries, then either all the settlors or all the beneficiaries must be members of the credit union.

Although each ascertainable trust estate is separately insured, it should be noted that in short-term trusts the insurable interest or interests may be very small, since the interests are computed only for the duration of the trust. Thus, if a trust is made irrevocable for a specified period of time, the beneficial interest will be calculated in terms of the length of time stated. A reversionary interest retained by the settlor is treated in the same manner as an individual account of the settlor.

As stated, the trust must be valid under local law. A trust which does not meet local requirements, such as one imposing no duties on the trustee or conveying no interest to the beneficiary, is of no effect for insurance purposes. An account in which such funds are invested is considered to be an individual account.

An account established pursuant to a revocable trust arrangement is insured as a form of individual account and is treated under Section B, supra, dealing with Testamentary Accounts.

IRA and Keogh accounts are separately insured, each up to $100,000. Although credit unions may serve as trustees or custodians for self-directed IRA, Roth IRA and Keogh accounts, once the funds in those accounts are taken out of the credit union, they are no longer insured.

In the case of an employee retirement fund where only a portion of the fund is placed in a credit union account, the amount of insurance available to an individual member/beneficiary on his interest in the account will be in proportion to his interest in the entire employee retirement fund. If, for example, the member's interest represents 10% of the entire plan funds, then he is presumed to have only a 10% interest in the plan account. Said another way, if a member has a vested interest of $10,000 in a municipal employees retirement plan and the trustee invests 25% of the total plan funds in a credit union, the member would be insured for only $2,500 on that credit union account. There is an exception, however. The member would be insured for $10,000 if the trustee can document, through records maintained in the ordinary course of business, that individual beneficiary's interests are segregated and the total vested interest of the member was, in fact, invested in that account.

Example 1

Question: Member S invests $45,000 in trust for B, the beneficiary. S also has an individual account containing $90,000 in the same credit union. What is the insurance coverage?

Answer: Both accounts are fully insured. The trust account is separately insured from the individual account of S (§§ 745.3(a)(1) and 745.9–1).

Example 2

Question: S invests funds in trust for A, B, C, D, and E. A, B, and C are members of the credit union, D, E, and S are not. What is the insurance coverage?

Answer: This is an uninsurable account. Where there is more than one settlor or more than one beneficiary, all the settlors or all the beneficiaries must be members to establish this type of account. Since D, E and S are not members, this account cannot legally be established or insured.

Example 3

Question: Member S invests $500,000 in trust for ABC Employees Retirement Fund. Some of the beneficiaries are members and some are not. What is the insurance coverage?

Answer: The account is insured as to the determinable interests of each member beneficiary to a maximum of $100,000 per member. Member interests not capable of evaluation and nonmember interests shall be added together and insured to a maximum of $100,000 in the aggregate (§ 745.9–1).

Example 3(a)

Question: Member S is trustee for the ABC Employees Retirement Fund containing $1,000,000. Member A has a determinable interest of $90,000 in the Fund (9% of the total). S invests $500,000 of the Fund in trust in an insured credit union and the remaining $500,000 elsewhere. Some of the beneficiaries of the Fund are members of the credit union and some are not. S does not segregate each employee's interest in the Fund. What is the insurance coverage?

Answer: The account is insured as to determinable interest of each member beneficiary, adjusted in proportion to the Fund's investment in the credit union. A's insured interest in the account is $45,000, or 9% of $500,000. This reflects the fact that only 50% of the Fund is in the account and A's interest in the account is in the same proportion as his interest in the overall plan. Each beneficiary who is a member would be similarly insured. Members' interests not capable of evaluation and nonmembers' interests are added together and insured to a maximum of $100,000 in the aggregate (§ 745.9–1).

Example 4

Question: Member A has an individual account of $100,000 and establishes an IRA and accumulates $50,000 in that account. Subsequently A becomes self-employed and establishes a Keogh account in the same credit union and accumulates $100,000 in that account. What is the insurance coverage?

Answer: Each of A's accounts would be separately insured for up to $100,000. In the example, A would be fully insured for $250,000 (§§ 745.3(a)(1) and 745.9–2).

Example 5

Question: Member A has a self-directed IRA account with $70,000 in it. The FCU is the trustee of the account. Member transfers $40,000 into a blue chip stock; $30,000 remains in the FCU. What is the insurance coverage?

Answer: Originally, the full $70,000 in A's IRA account is insured. The $40,000 is no longer insured once it is moved out of the FCU. The $30,000 remaining in the FCU is insured (§ 745.9–2).

Subpart B—Payment of Share Insurance and Appeals

§ 745.200 General.

(a) *Payment.* In the event of the liquidation of an insured credit union, the Board will promptly determine the insured accountholders thereof and the amount of the insured account or accounts of each such accountholder. Payment may be in cash, or its equivalent, or may be made by making available to each accountholder a transferred account in a new federally-insured credit union in the same community or in another federally-insured credit union or institution in an amount equal to the accountholder's insured account. Notwithstanding the foregoing, the Board may withhold payment of such portion of the insured account of any member as may be required to provide for payment of any direct or indirect liability to the closed credit union or the liquidating agent, which is not offset against a claim due from such credit union, pending the determination and payment of such liability by the member or any person liable therefor.

(b) *Amount of insurance.* The amount of insurance on an insured account shall be determined in accordance with the provisions of Subpart A of this part and the Federal Credit Union Act. For the purpose of determining insurance coverage, dividends earned in the ordinary course of business and posted to share accounts for any prior accounting or dividend period shall be deemed to be principal under this part. Dividends earned or accrued in the ordinary course of business, but not posted to share accounts, may be paid at the discretion of the liquidating agent. In making such determination, the liquidating agent will take into consideration whether the failure to post dividends earned or accrued was due to the fraud, embezzlement or accounting errors of credit union personnel. The liquidating agent may require an accountholder to submit documentation supporting any claim for unposted dividends not otherwise evidenced in the credit union records. However, in no event will dividend amounts be considered as principal for insurance purposes pursuant to this section if not consistent with the amounts paid on similar classes of shares.

(c) *Multiple accounts.* In the event an insured member holds more than one insured account in the same capacity, and the aggregate amount of such accounts (including share draft accounts held in such capacity) exceeds the amount of insurance afforded thereon, the insurance coverage will be prorated among the member's interest in all accounts held in the same capacity. In the case of individual accounts, the insurance proceeds shall be paid to the holder of the account, whether or not the holder is the beneficial owner. In the case of accounts which are owned jointly, the insurance proceeds shall be paid to the owners jointly. In the case of trust estates, the insurance proceeds shall be paid to the indicated trustee unless otherwise provided for in the trust instrument or under state law. In the case of corporations, partnerships and unincorporated associations engaged in an independent activity, the insurance proceeds shall be paid to the indicated holder of the account. Where insurance payment is in the form of a transferred account to another insured institution, the same rules shall be applied.

(d) *Computing time.* In computing any period of time prescribed by this subpart, the provisions of § 747.12(a) shall apply.

§ 745.201 Processing of Insurance Claims.

(a) *Delegations of authority.* The Agent for the Liquidating Agent ("Liquidating Agent") or his or her designee is authorized to make initial determinations with respect to insurance claims pursuant to the principles set forth in this Part, and to act on requests for reconsideration of the initial determination.

(b) *Initial determination.* In the event the Liquidating Agent determines that all or a portion of an accountholder's account is uninsured, the Liquidating Agent shall so notify the accountholder in writing, stating the reason(s) for such initial determination, and shall provide the accountholder with a certificate of claim in liquidation in the amount of the uninsured account from the Board in its capacity as Liquidating Agent for the insured credit union to enable the accountholder to share in the proceeds of the liquidation of the credit union, if any, up to the amount of the uninsured account.

(c) *Request for Reconsideration.* An accountholder may, at his or her option, request reconsideration from the Liquidating Agent of the initial determination within 30 days of the date of the initial determination, or directly appeal the initial determination to the Board pursuant to § 745.202 of this subpart. The Liquidating Agent shall act on the request for reconsideration within 30 days from its receipt.

§ 745.202 Appeal.

(a) *Time for filing.* Within 60 days after issuance of an initial determination, or of the determination on a request for reconsideration by the liquidating agent, the accountholder may appeal by filing with the Board a written request for appeal. The appeal may be filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

(b) *Content of request.* Any appeal must include:

(1) a statement of the facts on which the claim for insurance is based;

(2) a statement of the basis for the initial determination or determination on the request for reconsideration to which the accountholder objects and the alleged error in such determination, including citations to applicable statutes and regulations;

(3) any other evidence relied upon by the accountholder which was not previously provided to the Liquidating Agent.

(c) *Procedures for review of request.*

(1) Within 60 days of the date of the Board's receipt of an appeal, the Board may request in writing that the accountholder submit additional facts and records in support of its request. The account-holder shall have 45 days from the date of issuance of such written request to provide such additional information. Failure by the accountholder to provide additional information may, as determined solely by the Board, result in denial of the accountholder's appeal.

(2) Within 60 days from the date of the Board's receipt of an appeal, the accountholder may amend or supplement the request in writing. In the event that the accountholder does amend or supplement the request, the provisions of paragraph (c)(1) of this section with respect to requests for additional information and responses to such requests shall apply with equal force to any such amendment or supplement to a request.

(d) *Determination on appeal.*

(1) Within 180 days from the date of the receipt of an appeal by the Board, the Board shall issue a decision determining the extent of the accountholder's insurance pursuant to the rules of this Part.

(2) The determination by the Board on appeal shall be provided to the accountholder in writing, stating the reason(s) for the determination, and shall constitute a final Agency order regarding the accountholder's claim for insurance.

(3) If the Board determines that the account-holder is entitled to the amount of insurance claimed or portion thereof, upon payment of such insurance the accountholder shall promptly surrender to the Board the certificate of claim in liquidation provided in connection with the initial determination. In the event that the Board determines that the accountholder is only entitled to a portion of the amount of insurance claimed, upon the accountholder's surrender of such certificate a new certificate of claim in liquidation will be provided which reflects the revised amount of the uninsured account.

(4) Failure by the Board to issue a determination on appeal of the accountholder's claim for insurance within the 180-day period provided for under this paragraph (d)(1) shall be deemed to be a denial of such claim for purposes of Section 745.203 of this subpart.

§ 745.203 Judicial Review.

(a) For purposes of seeking judicial review of actions taken pursuant to this subpart, only a determination on appeal issued by the Board pursuant to Section 745.202 of this subpart shall constitute a final determination regarding an accountholder's claim for insurance.

(b) Failure to file an appeal with regard to an initial determination, or a decision rendered on a request for reconsideration within the applicable time periods shall constitute a failure by the accountholder to exhaust available administrative remedies and, due to such failure, any objections to the initial determination or request for reconsideration shall be deemed to be waived and such determination shall be deemed to have been accepted by, and binding upon, the accountholder.

(c) Final determination by the Board is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States Court of Appeals for the District of Columbia or the court of appeals for the Federal judicial circuit where the credit union's principal place of business is located. Such action must be filed not later than 60 days after such final determination is ordered.

Part 747

Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations

§ 747.0 Scope.

(a) This Part describes the various formal and informal adjudicative actions and non-adjudicative proceedings available to the National Credit Union Administration Board ("NCUA Board"), the grounds for those actions and proceedings, and the procedures used in formal and informal hearings related to each available action. As mandated by Section 916 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (12 U.S.C. § 1818 note), this Part incorporates uniform rules of practice and procedure governing formal adjudications generally, as well as proceedings involving cease-and-desist actions, assessment of civil money penalties, and removal, prohibition and suspension actions. In addition, the Uniform Rules are incorporated in other subparts of this Part which provide for formal adjudications. The administrative actions and proceedings described herein, as well as the grounds and hearing procedures for each, are controlled by Sections 120(b) (except where the Federal credit union is closed due to insolvency), 202(a)(3) and 206 of the Act (12 U.S.C. §§ 1766(b), 1782(a)(3), 1786). Should any provision of this Part be inconsistent with these or any other provisions of the Act, as amended, the Act shall control. Judicial enforcement of any action or order described in this Part, as well as judicial review thereof, shall be as prescribed under the Act (12 U.S.C. § 1751 *et seq.*) and the Administrative Procedure Act (5 U.S.C. § 500 *et seq.*).

(b) As used in this Part, the term insured credit union means any Federal credit union or any state-chartered credit union insured under Subchapter II of the Act unless the context indicates otherwise.

Subpart A—Uniform Rules of Practice and Procedure

§ 747.1 Scope.

This Subpart prescribes uniform rules of practice and procedure applicable to adjudicatory proceedings required to be conducted on the record after opportunity for a hearing under the following statutory provisions:

(a) Cease-and-desist proceedings under Section 206(e) of the Act (12 U.S.C. 1786(e));

(b) Removal and prohibition proceedings under Section 206(g) of the Act (12 U.S.C. 1786(g));

(c) Assessment of civil money penalties by the NCUA Board against institutions and institution-affiliated parties for any violation of:

(1) Section 202 of the Act, pursuant to 12 U.S.C. 1782(a);

(2) Section 1120 of FIRREA (12 U.S.C. 3349), or any order or regulation issued thereunder;

(3) The terms of any final or temporary order issued under section 206 of the Act or any written agreement executed by the National Credit Union Administration ("NCUA"), any condition imposed in writing by the NCUA in connection with the grant of an application or request, certain unsafe or unsound practices or breaches of fiduciary duty, or any law or regulation not otherwise provided herein, pursuant to 12 U.S.C. 1786(k); and

(4) Any provision of law referenced in section 102(f) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(f)) or any order or regulation issued thereunder;

(d) Remedial action under section 102(g) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(g)); and

(e) This subpart also applies to all other adjudications required by statute to be determined on the record after opportunity for an agency hearing, unless otherwise specifically provided for in Subparts B through J of this Part.

§ 747.2 Rules of Construction.

For purposes of this Subpart:

(a) Any term in the singular includes the plural, and the plural includes the singular, if such use would be appropriate;

(b) Any use of a masculine, feminine, or neuter gender encompasses all three, if such use would be appropriate;

(c) The term *counsel* includes a non-attorney representative; and

(d) Unless the context requires otherwise, a party's counsel of record, if any, may, on behalf of that party, take any action required to be taken by the party.

§ 747.3 Definitions.

For purposes of this Subpart, unless explicitly stated to the contrary:

(a) *Administrative law judge* means one who presides at an administrative hearing under authority set forth at 5 U.S.C. 556.

(b) *Adjudicatory proceeding* means a proceeding conducted pursuant to these rules and leading to the formulation of a final order other than a regulation.

(c) *Decisional employee* means any member of the NCUA's or administrative law judge's staff who has not engaged in an investigative or prosecutorial role in a proceeding and who may assist the Agency or the administrative law judge, respectively, in preparing orders, recommended decisions, decisions, and other documents under the Uniform Rules.

(d) *Enforcement Counsel* means any individual who files a notice of appearance as counsel on behalf of the NCUA in an adjudicatory proceeding.

(e) *Final order* means an order issued by the NCUA with or without the consent of the affected institution or the institution-affiliated party, that has become final, without regard to the pendency of any petition for reconsideration or review.

(f) *Institution* includes:

(1) Any Federal credit union as that term is defined in Section 101(1) of the Act (12 U.S.C. 1752(1)); and

(2) Any insured state credit union as that term is defined in Section 101(7) of the Act (12 U.S.C. 1752(7)).

(g) *Institution-affiliated party* means any institution-affiliated party as that term is defined in Section 206(r) of the Act (12 U.S.C. 1786(r)).

(h) *Local rules* means those rules promulgated by the NCUA in the Subparts of this Part other than Subpart A of this Part.

(i) *OFIA* means the Office of Financial Institution Adjudication, which is the executive body charged with overseeing the administration of administrative enforcement proceedings for the NCUA, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS).

(j) *Party* means the NCUA and any person named as a party in any notice.

(k) *Person* means an individual, sole proprietor, partnership, corporation, unincorporated association, trust, joint venture, pool, syndicate, agency, or other entity or organization, including an institution as defined in paragraph (f) of this section.

(l) *Respondent* means any party other than the NCUA.

(m) *Uniform Rules* means those rules in Subpart A of this Part that are common to the NCUA, the OCC, the Board, the FDIC, and the OTS.

(n) *Violation* includes any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

§ 747.4 Authority of the NCUA Board.

The NCUA Board may, at any time during the pendency of a proceeding, perform, direct the performance of, or waive performance of, any act which could be done or ordered by the administrative law judge.

§ 747.5 Authority of the Administrative Law Judge.

(a) *General rule.* All proceedings governed by this Part shall be conducted in accordance with the provisions of Chapter 5 of Title 5 of the United States Code. The administrative law judge shall have all powers necessary to conduct a proceeding in a fair and impartial manner and to avoid unnecessary delay.

(b) *Powers.* The administrative law judge shall have all powers necessary to conduct the proceeding in accordance with paragraph (a) of this Section, including the following powers:

(1) To administer oaths and affirmations;

(2) To issue subpoenas, subpoenas duces tecum, and protective orders, as authorized by this Part, and to quash or modify any such subpoenas and orders;

(3) To receive relevant evidence and to rule upon the admission of evidence and offers of proof;

(4) To take or cause depositions to be taken as authorized by this Subpart;

(5) To regulate the course of the hearing and the conduct of the parties and their counsel;

(6) To hold scheduling and/or pre-hearing conferences as set forth in § 747.31;

(7) To consider and rule upon all procedural and other motions appropriate in an adjudicatory proceeding, provided that only the NCUA Board shall have the power to grant any motion to dismiss the proceeding or to decide any other motion that results in a final determination of the merits of the proceeding;

(8) To prepare and present to the NCUA Board a recommended decision as provided herein;

(9) To recuse himself or herself by motion made by a party or on his or her own motion;

(10) To establish time, place and manner limitations on the attendance of the public and the media for any public hearing; and

(11) To do all other things necessary and appropriate to discharge the duties of a presiding officer.

§ 747.6 Appearance and Practice in Adjudicatory Proceedings.

(a) *Appearance before the NCUA or an administrative law judge.* (1) *By attorneys.* Any member in good standing of the bar of the highest court of any state, commonwealth, possession, territory of the United States, or the District of Columbia may represent others before the NCUA if such attorney is not currently suspended or debarred from practice before the NCUA.

(2) *By non-attorneys.* An individual may appear on his or her own behalf; a member of a partnership may represent the partnership; a duly authorized officer, director, or employee of any government unit, agency, institution, corporation, or authority may represent that unit, agency, institution, corporation, or authority if such officer, director, or employee is not currently suspended or debarred from practice before the NCUA.

(3) *Notice of appearance.* Any individual acting as counsel on behalf of a party, including the NCUA Board, shall file a notice of appearance with OFIA at or before the time that the individual submits papers or otherwise appears on behalf of a party in the adjudicatory proceeding. The notice of appearance must include a written declaration that the individual is currently qualified as provided in paragraph (a)(1) or (a)(2) of this section and is authorized to represent the particular party. By filing a notice of appearance on behalf of a party in an adjudicatory proceeding, the counsel agrees and represents that he or she is authorized to accept service on behalf of the represented party and that, in the event of withdrawal from representation, he or she will, if required by the administrative law judge, continue to accept service until new counsel has filed a notice of appearance or until the represented party indicates that he or she will proceed on a *pro se* basis.

(b) *Sanctions.* Dilatory, obstructionist, egregious, contemptuous, or contumacious conduct at any phase of any adjudicatory proceeding may be grounds for exclusion or suspension of counsel from the proceeding.

§ 747.7 Good Faith Certification.

(a) *General requirement.* Every filing or submission of record following the issuance of a notice shall be signed by at least one counsel of record in his or her individual name and shall state that counsel's address and telephone number. A party who acts as his or her own counsel shall sign his or her individual name and state his or her address and telephone number on every filing or submission of record.

(b) *Effect of signature.* (1) The signature of counsel or a party shall constitute a certification that: the counsel or party has read the filing or submission of record; to the best of his or her knowledge, information, and belief formed after reasonable inquiry, the filing or submission of record is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and the filing or submission of record is not made for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

(2) If a filing or submission of record is not signed, the administrative law judge shall strike the filing or submission of record, unless it is signed promptly after the omission is called to the attention of the pleader or movant.

(c) *Effect of making oral motion or argument.* The act of making any oral motion or oral argument by any counsel or party constitutes a certification that to the best of his or her knowledge, information, and belief formed after reasonable inquiry, his or her statements are well-grounded in fact and are warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and are not made

for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

§ 747.8 Conflicts of Interest.

(a) *Conflict of interest in representation.* No person shall appear as counsel for another person in an adjudicatory proceeding if it reasonably appears that such representation may be materially limited by that counsel's responsibilities to a third person or by the counsel's own interests. The administrative law judge may take corrective measures at any stage of a proceeding to cure a conflict of interest in representation, including the issuance of an order limiting the scope of representation or disqualifying an individual from appearing in a representative capacity for the duration of the proceeding.

(b) *Certification and waiver.* If any person appearing as counsel represents two or more parties to an adjudicatory proceeding or also represents a non-party on a matter relevant to an issue in the proceeding, counsel must certify in writing at the time of filing the notice of appearance required by § 747.6(a):

(1) That the counsel has personally and fully discussed the possibility of conflicts of interest with each such party and non-party; and

(2) That each such party and non-party waives any right it might otherwise have had to assert any known conflicts of interest or to assert any non-material conflicts of interest during the course of the proceeding.

§ 747.9 Ex Parte Communications.

(a) *Definition.* (1) *Ex parte communication* means any material oral or written communication relevant to the merits of an adjudicatory proceeding that was neither on the record nor on reasonable prior notice to all parties that takes place between—

(i) An interested person outside the NCUA (including such person's counsel); and

(ii) The administrative law judge handling that proceeding, the NCUA Board, or a decisional employee.

(2) *Exception.* A request for status of the proceeding does not constitute an ex parte communication.

(b) *Prohibition of ex parte communications.* From the time the notice is issued by the NCUA Board until the date that the NCUA Board issues its final decision pursuant to § 747.40(c):

(1) No interested person outside the NCUA shall make or knowingly cause to be made an ex parte communication to any member of the NCUA Board, the administrative law judge, or a decisional employee; and

(2) No member of the NCUA Board, administrative law judge, or decisional employee shall make or knowingly cause to be made to any interested person outside the NCUA any ex parte communication.

(c) *Procedure upon occurrence of ex parte communication.* If an ex parte communication is received by the administrative law judge, a member of the NCUA Board or any other person identified in paragraph (a) of this Section, that person shall cause all such written communications (or, if the communication is oral, a memorandum stating the substance of the communication) to be placed on the record of the proceeding and served on all parties. All other parties to the proceeding shall have an opportunity, within ten days of receipt of service of the ex parte communication, to file responses thereto and to recommend any sanctions, in accordance with paragraph (d) of this Section, that they believe to be appropriate under the circumstances.

(d) *Sanctions.* Any party or his or her counsel who makes a prohibited ex parte communication, or who encourages or solicits another to make any such communication, may be subject to any appropriate sanction or sanctions imposed by the NCUA Board or the administrative law judge, including, but not limited to, exclusion from the proceedings and an adverse ruling on the issue which is the subject of the prohibited communication.

(e) *Separation of functions.* Except to the extent required for the disposition of ex parte matters as authorized by law, the administrative law judge may not consult a person or party on any matter relevant to the merits of the adjudication, unless on notice and opportunity for all parties to participate. An employee or agent engaged in the performance of investigative or prosecuting functions for the NCUA in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review of the recommended decision under section 747.40, except as witness or counsel in public proceedings.

§ 747.10 Filing of Papers.

(a) *Filing.* Any papers required to be filed, excluding documents produced in response to a discovery request pursuant to §§ 747.25 and 747.26, shall be filed with the OFIA, except as otherwise provided.

(b) *Manner of filing.* Unless otherwise specified by the NCUA Board or the administrative law judge, filing may be accomplished by:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if expressly authorized, and upon any conditions specified by the NCUA Board or the administrative law judge. All papers filed by electronic media shall also concurrently be filed in accordance with paragraph (c) of this Section.

(c) *Formal requirements as to papers filed.* (1) *Form.* All papers filed must set forth the name, address, and telephone number of the counsel or party making the filing and must be accompanied by a certification setting forth when and how service has been made on all other parties. All papers filed must be double spaced and printed or typewritten on 8 1/2 x 11 inch paper, and must be clear and legible.

(2) *Signature.* All papers must be dated and signed as provided in § 747.7.

(3) *Caption.* All papers filed must include at the head thereof, or on a title page, the name of the NCUA and of the filing party, the title and docket number of the proceeding, and the subject of the particular paper.

(4) *Number of copies.* Unless otherwise specified by the NCUA Board, or the administrative law judge, an original and one copy of all documents and papers shall be filed, except that only one copy of transcripts of testimony and exhibits shall be filed.

§ 747.11 Service of Papers.

(a) *By the parties.* Except as otherwise provided, a party filing papers shall serve a copy upon the counsel of record for all other parties to the proceeding so represented, and upon any party not so represented.

(b) *Method of service.* Except as provided in paragraphs (c)(2) and (d) of this Section, a serving party shall use one or more of the following methods of service:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if the parties mutually agree. Any papers served by electronic media shall also concurrently be served in accordance with the requirements of § 747.10(c).

(c) *By the NCUA Board or the administrative law judge.* (1) All papers required to be served by the NCUA Board or the administrative law judge upon a party who has appeared in the proceeding in accordance with § 747.6, shall be served by any means specified in paragraph (b) of this section.

(2) If a party has not appeared in the proceeding in accordance with § 747.6, the NCUA Board or the administrative law judge shall make service by any of the following methods:

(i) By personal service;

(ii) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(iii) If the person to be served is a corporation or other association, by delivery to an officer, managing or general agent, or to any other agent authorized by appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(iv) By registered or certified mail addressed to the person's last known address; or

(v) By any other method reasonably calculated to give actual notice.

(d) *Subpoenas.* Service of a subpoena may be made:

(1) By personal service;

(2) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(3) By delivery to an agent, which, in the case of a corporation or other association, is delivery to an officer, managing or general agent, or to any other agent authorized by

appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(4) By registered or certified mail addressed to the person's last known address; or

(5) By any other method reasonably calculated to give actual notice.

(e) *Area of service.* Service in any state, territory, possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, possession of the United States, or the District of Columbia, or on any person as otherwise provided by law, is effective without regard to the place where the hearing is held, provided that if service is made on a foreign bank in connection with an action or proceeding involving one or more of its branches or agencies located in any state, territory, possession of the United States, or the District of Columbia, service shall be made on at least one branch or agency so involved.

§ 747.12 Construction of Time Limits.

(a) *General rule.* In computing any period of time prescribed by this subpart, the date of the act or event that commences the designated period of time is not included. The last day so computed is included unless it is a Saturday, Sunday, or Federal holiday. When the last day is a Saturday, Sunday, or Federal holiday, the period runs until the end of the next day that is not a Saturday, Sunday, or Federal holiday. Intermediate Saturdays, Sundays, and Federal holidays are included in the computation of time. However, when the time period within which an act is to be performed is ten days or less, not including any additional time allowed for in § 747.12(c), intermediate Saturdays, Sundays, and Federal holidays are not included.

(b) *When papers are deemed to be filed or served.*

(1) Filing and service are deemed to be effective:

(i) In the case of personal service or same day commercial courier delivery, upon actual service;

(ii) In the case of overnight commercial delivery service, U.S. Express Mail delivery, or first class, registered, or certified mail, upon deposit in or delivery to an appropriate point of collection;

(iii) In the case of transmission by electronic media, as specified by the authority receiving the filing, in the case of filing, and as agreed among the parties, in the case of service.

(2) The effective filing and service dates specified in paragraph (b)(1) of this Section may be modified by the NCUA Board or administrative law judge in the case of filing or by agreement of the parties in the case of service.

(c) *Calculation of time for service and filing of responsive papers.* Whenever a time limit is measured by a prescribed period from the service of any notice or paper, the applicable time limits are calculated as follows:

(1) If service is made by first class, registered, or certified mail, add three calendar days to the prescribed period;

(2) If service is made by express mail or overnight delivery service, add one calendar day to the prescribed period; or

(3) If service is made by electronic media transmission, add one calendar day to the prescribed period, unless otherwise determined by the NCUA Board or the administrative law judge in the case of filing, or by agreement among the parties in the case of service.

§ 747.13 Change of Time Limits.

Except as otherwise provided by law, the administrative law judge may, for good cause shown, extend the time limits prescribed by the Uniform Rules or by any notice or order issued in the proceedings. After the referral of the case to the NCUA Board pursuant to § 747.38, the NCUA Board may grant extensions of the time limits for good cause shown. Extensions may be granted upon the motion of a party after notice and opportunity to respond is afforded all non-moving parties, or upon the NCUA Board's or the administrative law judge's own motion.

§ 747.14 Witness Fees and Expenses.

Witnesses subpoenaed for testimony or depositions shall be paid the same fees for attendance and mileage as are paid in the United States district courts in proceedings in which the United States is a party, provided that, in the case of a discovery subpoena addressed to a party, no witness fees or mileage need be paid. Fees for witnesses shall be tendered in advance by the party requesting the subpoena, except that fees and

mileage need not be tendered in advance where the NCUA is the party requesting the subpoena. The NCUA shall not be required to pay any fees to, or expenses of, any witness not subpoenaed by the NCUA.

§ 747.15 Opportunity for Informal Settlement.

Any respondent may, at any time in the proceeding, unilaterally submit to Enforcement Counsel written offers or proposals for settlement of a proceeding, without prejudice to the rights of any of the parties. No such offer or proposal shall be made to any NCUA representative other than Enforcement Counsel. Submission of a written settlement offer does not provide a basis for adjourning or otherwise delaying all or any portion of a proceeding under this Part. No settlement offer or proposal, or any subsequent negotiation or resolution, is admissible as evidence in any proceeding.

§ 747.16 NCUA's Right to Conduct Examination.

Nothing contained in this Subpart limits in any manner the right of the NCUA to conduct any examination, inspection, or visitation of any institution or institution-affiliated party, or the right of the NCUA to conduct or continue any form of investigation authorized by law.

§ 747.17 Collateral Attacks on Adjudicatory Proceeding.

If an interlocutory appeal or collateral attack is brought in any court concerning all or any part of an adjudicatory proceeding, the challenged adjudicatory proceeding shall continue without regard to the pendency of that court proceeding. No default or other failure to act as directed in the adjudicatory proceeding within the times prescribed in this Subpart shall be excused based on the pendency before any court of any interlocutory appeal or collateral attack.

§ 747.18 Commencement of Proceeding and Contents of Notice.

(a) *Commencement of proceeding.* (1) A proceeding governed by this Subpart is commenced by issuance of a notice by the NCUA Board.

(2) The notice must be served by the NCUA Board upon the respondent and given to any other appropriate financial institution supervisory authority where required by law.

(3) The notice must be filed with the OFIA.

(b) *Contents of notice.* The notice must set forth:

(1) The legal authority for the proceeding and for the NCUA's jurisdiction over the proceeding;

(2) A statement of the matters of fact or law showing that the NCUA is entitled to relief;

(3) A proposed order or prayer for an order granting the requested relief;

(4) The time, place, and nature of the hearing as required by law or regulation;

(5) The time within which to file an answer as required by law or regulation;

(6) The time within which to request a hearing as required by law or regulation; and

(7) That the answer and/or request for a hearing shall be filed with OFIA.

§ 747.19 Answer.

(a) *When.* Within 20 days of service of the notice, respondent shall file an answer as designated in the notice. In a civil money penalty proceeding, respondent shall also file a request for a hearing within 20 days of service of the notice.

(b) *Content of answer.* An answer must specifically respond to each paragraph or allegation of fact contained in the notice and must admit, deny, or state that the party lacks sufficient information to admit or deny each allegation of fact. A statement of lack of information has the effect of a denial. Denials must fairly meet the substance of each allegation of fact denied; general denials are not permitted. When a respondent denies part of an allegation, that part must be denied and the remainder specifically admitted. Any allegation of fact in the notice which is not denied in the answer must be deemed admitted for purposes of the proceeding. A respondent is not required to respond to the portion of a notice that constitutes the prayer for relief or proposed order. The answer must set forth affirmative defenses, if any, asserted by the respondent.

(c) *Default.* (1) *Effect of failure to answer.* Failure of a respondent to file an answer required by this Section within the time provided constitutes a waiver of his or her right to appear and contest the allegations in the notice. If no timely answer is filed, the administrative law judge, upon motion of the Enforcement Counsel, shall file with the NCUA Board a recommended decision containing the findings and the relief sought in the notice. Any final order issued by the NCUA Board based upon a respondent's failure to answer is deemed to be an order issued upon consent.

(2) *Effect of failure to request a hearing in civil money penalty proceedings.* If respondent

fails to request a hearing as required by law within the time provided, the notice of assessment constitutes a final and unappealable order.

§ 747.20 Amended Pleadings.

(a) *Amendments.* The notice or answer may be amended or supplemented at any stage of the proceeding. The respondent must answer an amended notice within the time remaining for the respondent's answer to the original notice, or within ten days after service of the amended notice, whichever period is longer, unless the NCUA Board or administrative law judge orders otherwise for good cause.

(b) *Amendments to conform to the evidence.* When issues not raised in the notice or answer are tried at the hearing by express or implied consent of the parties, they will be treated in all respects as if they had been raised in the notice or answer, and no formal amendments are required. If evidence is objected to at the hearing on the ground that it is not within the issues raised by the notice or answer, the administrative law judge may admit the evidence when admission is likely to assist in adjudicating the merits of the action and the objecting party fails to satisfy the administrative law judge that the admission of such evidence would unfairly prejudice that party's action or defense upon the merits. The administrative law judge may grant a continuance to enable the objecting party to meet such evidence.

§ 747.21 Failure to Appear.

(a) Failure of a respondent to appear in person at the hearing or by a duly authorized counsel constitutes a waiver of respondent's right to a hearing and is deemed an admission of the facts as alleged and consent to the relief sought in the notice. Without further proceedings or notice to the respondent, the administrative law judge shall file with the NCUA Board a recommended decision containing the findings and the relief sought in the notice.

§ 747.22 Consolidation and Severance of Actions.

(a) *Consolidation.* (1) On the motion of any party, or on the administrative law judge's own motion, the administrative law judge may consolidate, for some or all purposes, any two or more proceedings, if each such proceeding involves or arises out of the same transaction, occurrence or series of transactions or occurrences, or involves at least one common respondent or a material common question of law or fact, unless such consolidation would cause unreasonable delay or injustice.

(2) In the event of consolidation under paragraph (a)(1) of this Section, appropriate adjustment to the prehearing schedule must be made to avoid unnecessary expense, inconvenience, or delay.

(b) *Severance.* The administrative law judge may, upon the motion of any party, sever the proceeding for separate resolution of the matter as to any respondent only if the administrative law judge finds that:

(1) Undue prejudice or injustice to the moving party would result from not severing the proceeding; and

(2) Such undue prejudice or injustice would outweigh the interests of judicial economy and expedition in the complete and final resolution of the proceeding.

§ 747.23 Motions.

(a) *In writing.* (1) Except as otherwise provided herein, an application or request for an order or ruling must be made by written motion.

(2) All written motions must state with particularity the relief sought and must be accompanied by a proposed order.

(3) No oral argument may be held on written motions except as otherwise directed by the administrative law judge. Written memoranda, briefs, affidavits, or other relevant material or documents may be filed in support of or in opposition to a motion.

(b) *Oral motions.* A motion may be made orally on the record unless the administrative law judge directs that such motion be reduced to writing.

(c) *Filing of motions.* Motions must be filed with the administrative law judge, except that upon the filing of the recommended decision, motions must be filed with the NCUA Board.

(d) *Responses.* (1) Except as otherwise provided herein, within ten days after service of any written motion, or within such other period of time as may be established by the administrative law judge or the NCUA Board, any party may file a written response to a motion. The administrative law judge shall not rule on any oral or written

motion before each party has had an opportunity to file a response.

(2) The failure of a party to oppose a written motion or an oral motion made on the record is deemed a consent by that party to the entry of an order substantially in the form of the order accompanying the motion.

(e) *Dilatory motions.* Frivolous, dilatory or repetitive motions are prohibited. The filing of such motions may form the basis for sanctions.

(f) *Dispositive motions.* Dispositive motions are governed by §§ 747.29 and 747.30.

§ 747.24 Scope of Document Discovery.

(a) *Limits on discovery.* (1) Subject to the limitations set out in paragraphs (b), (c), and (d) of this section, a party to a proceeding under this subpart may obtain document discovery by serving a written request to produce documents. For purposes of a request to produce documents, the term "documents" may be defined to include drawings, graphs, charts, photographs, recordings, data stored in electronic form, and other data compilations from which information can be obtained, or translated, if necessary, by the parties through detection devices into reasonably usable form, as well as written material of all kinds.

(2) Discovery by use of deposition is governed by subpart I of this part.

(3) Discovery by use of interrogatories is not permitted.

(b) *Relevance.* A party may obtain document discovery regarding any matter, not privileged, that has material relevance to the merits of the pending action. Any request to produce documents that calls for irrelevant material, that is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or that seeks to obtain privileged documents will be denied or modified. A request is unreasonable, oppressive, excessive in scope, or unduly burdensome if, among other things, it fails to include justifiable limitations on the time period covered and the geographic locations to be searched, the time provided to respond in the request is inadequate, or the request calls for copies of documents to be delivered to the requesting party and fails to include the requester's written agreement to pay in advance for the copying, in accordance with § 747.25.

(c) *Privileged matter.* Privileged documents are not discoverable. Privileges include the attorney-client privilege, work-product privilege, any government's or government agency's deliberative-process privilege, and any other privileges the Constitution, any applicable act of Congress, or the principles of common law provide.

(d) *Time limits.* All discovery, including all responses to discovery requests, shall be completed at least 20 days prior to the date scheduled for the commencement of the hearing, except as provided in the Local Rules. No exceptions to this time limit shall be permitted, unless the administrative law judge finds on the record that good cause exists for waiving the requirements of this paragraph.

§ 747.25 Request for Document Discovery from Parties.

(a) *General rule.* Any party may serve on any other party a request to produce for inspection any discoverable documents that are in the possession, custody, or control of the party upon whom the request is served. The request must identify the documents to be produced either by individual item or by category, and must describe each item and category with reasonable particularity. Documents must be produced as they are kept in the usual course of business or must be organized to correspond with the categories in the request.

(b) *Production or copying.* The request must specify a reasonable time, place, and manner for production and performing any related acts. In lieu of inspecting the documents, the requesting party may specify that all or some of the responsive documents be copied and the copies delivered to the requesting party. If copying of fewer than 250 pages is requested, the party to whom the request is addressed shall bear the cost of copying and shipping charges. If a party requests 250 pages or more of copying, the requesting party shall pay for the copying and shipping charges. Copying charges are the current per-page copying rate imposed by 12 CFR § 792.5 implementing the Freedom of Information Act (5 U.S.C. 552). The party to whom the request is addressed may require payment in advance before producing the documents.

(c) *Obligation to update responses.* A party who has responded to a discovery request with a response that was complete when made is not required to supplement the response to include documents thereafter acquired, unless the responding party learns that:

(1) The response was materially incorrect when made; or

(2) The response, though correct when made, is no longer true and a failure to amend the response is, in substance, a knowing concealment.

(d) *Motions to limit discovery.* (1) Any party that objects to a discovery request may, within ten days of being served with such request, file a motion in accordance with the provisions of § 747.23 to strike or otherwise limit the request. If an objection is made to only a portion of an item or category in a request, the portion objected to shall be specified. Any objections not made in accordance with this paragraph and § 747.23 are waived.

(2) The party who served the request that is the subject of a motion to strike or limit may file a written response within five days of service of the motion. No other party may file a response.

(e) *Privilege.* At the time other documents are produced, the producing party must reasonably identify all documents withheld on the grounds of privilege and must produce a statement of the basis for the assertion of privilege. When similar documents that are protected by deliberative process, attorney work-product, or attorney-client privilege are voluminous, these documents may be identified by category instead of by individual document. The administrative law judge retains discretion to determine when the identification by category is insufficient.

(f) *Motions to compel production.* (1) If a party withholds any documents as privileged or fails to comply fully with a discovery request, the requesting party may, within ten days of the assertion of privilege or of the time the failure to comply becomes known to the requesting party, file a motion in accordance with the provisions of § 747.23 for the issuance of a subpoena compelling production.

(2) The party who asserted the privilege or failed to comply with the request may file a written response to a motion to compel within five days of service of the motion. No other party may file a response.

(g) *Ruling on motions.* After the time for filing responses pursuant to this section has expired, the administrative law judge shall rule promptly on all motions filed pursuant to this section. If the administrative law judge determines that a discovery request, or any of its terms, calls for irrelevant material, is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or seeks to obtain privileged documents, he or she may deny or modify the request, and may issue appropriate protective orders, upon such conditions as justice may require. The pendency of a motion to strike or limit discovery or to compel production is not a basis for staying or continuing the proceeding, unless otherwise ordered by the administrative law judge. Notwithstanding any other provision in this part, the administrative law judge may not release, or order a party to produce, documents withheld on grounds of privilege if the party has stated to the administrative law judge its intention to file a timely motion for interlocutory review of the administrative law judge's order to produce the documents, and until the motion for interlocutory review has been decided.

(h) *Enforcing discovery subpoenas.* If the administrative law judge issues a subpoena compelling production of documents by a party, the subpoenaing party may, in the event of noncompliance and to the extent authorized by applicable law, apply to any appropriate United States district court for an order requiring compliance with the subpoena. A party's right to seek court enforcement of a subpoena shall not in any manner limit the sanctions that may be imposed by the administrative law judge against a party who fails to produce subpoenaed documents.

§ 747.26 Document Subpoenas to Nonparties.

(a) *General rules.* (1) Any party may apply to the administrative law judge for the issuance of a document discovery subpoena addressed to any person who is not a party to the proceeding. The application must contain a proposed document subpoena and a brief statement showing the general relevance and reasonableness of the scope of documents sought. The subpoenaing party shall specify a reasonable time, place, and manner for making production in response to the document subpoena.

(2) A party shall only apply for a document subpoena under this Section within the time period during which such party could serve a discovery request under § 747.24(d). The party obtaining the document subpoena is responsible for serving it on the subpoenaed person and for serving copies on all parties. Document subpoenas may be served in any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law.

(3) The administrative law judge shall promptly issue any document subpoena requested pursuant to this Section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon such conditions as may be consistent with the Uniform Rules.

(b) *Motion to quash or modify.* (1) Any person to whom a document subpoena is directed may file a motion to quash or modify such subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant shall serve the motion on all parties, and any party may respond to such motion within ten days of service of the motion.

(2) Any motion to quash or modify a document subpoena must be filed on the same basis, including the assertion of privilege, upon which a party could object to a discovery request under § 747.25(d), and during the same time limits during which such an objection could be filed.

(c) *Enforcing document subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this Section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with so much of the document subpoena as the administrative law judge has not quashed or modified. A party's right to seek court enforcement of a document subpoena shall in no way limit the sanctions that may be imposed by the administrative law judge on a party who induces a failure to comply with subpoenas issued under this Section.

§ 747.27 Deposition of Witness Unavailable for Hearing.

(a) *General rules.* (1) If a witness will not be available for the hearing, a party desiring that witness's testimony for the record may apply in accordance with the procedures set forth in paragraph (a)(2) of this Section, to the administrative law judge for the issuance of a subpoena, including a subpoena duces tecum, requiring the attendance of the witness at a deposition. The administrative law judge may issue a deposition subpoena under this Section upon showing that:

(i) The witness will be unable to attend or may be prevented from attending the hearing because of age, sickness or infirmity, or will otherwise be unavailable;

(ii) The witness's unavailability was not procured or caused by the subpoenaing party;

(iii) The testimony is reasonably expected to be material; and

(iv) Taking the deposition will not result in any undue burden to any other party and will not cause undue delay of the proceeding.

(2) The application must contain a proposed deposition subpoena and a brief statement of the reasons for the issuance of the subpoena. The subpoena must name the witness whose deposition is to be taken and specify the time and place for taking the deposition. A deposition subpoena may require the witness to be deposed at any place within the country in which that witness resides or has a regular place of employment or such other convenient place as the administrative law judge shall fix.

(3) Any requested subpoena that sets forth a valid basis for its issuance must be promptly issued, unless the administrative law judge on his or her own motion, requires a written response or requires attendance at a conference concern ing whether the requested subpoena should be issued.

(4) The party obtaining a deposition subpoena is responsible for serving it on the witness and for serving copies on all parties. Unless the administrative law judge orders otherwise, no deposition under this Section shall be taken on fewer than ten days' notice to the witness and all parties. Deposition subpoenas may be served in any state, territory, or possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, or possession of the United States, or the District of Columbia, or as otherwise permitted by law.

(b) *Objections to deposition subpoenas.* (1) The witness and any party who has not had an opportunity to oppose a deposition subpoena issued under this Section may file a motion with the administrative law judge to quash or modify the subpoena prior to the time for compliance specified in the subpoena, but not more than ten days after service of the subpoena.

(2) A statement of the basis for the motion to quash or modify a subpoena issued under this

Section must accompany the motion. The motion must be served on all parties.

(c) *Procedure upon deposition.* (1) Each witness testifying pursuant to a deposition subpoena must be duly sworn, and each party shall have the right to examine the witness. Objections to questions or documents must be in short form, stating the grounds for the objection. Failure to object to questions or documents is not deemed a waiver except where the ground for the objection might have been avoided if the objection had been timely presented. All questions, answers, and objections must be recorded.

(2) Any party may move before the administrative law judge for an order compelling the witness to answer any questions the witness has refused to answer or submit any evidence the witness has refused to submit during the deposition.

(3) The deposition must be subscribed by the witness, unless the parties and the witness, by stipulation, have waived the signing, or the witness is ill, cannot be found, or has refused to sign. If the deposition is not subscribed by the witness, the court reporter taking the deposition shall certify that the transcript is a true and complete transcript of the deposition.

(d) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any order of the administrative law judge which directs compliance with all or any portion of a deposition subpoena under paragraph (b) or (c)(3) of this Section, the subpoenaing party or other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with the portions of the subpoena that the administrative law judge has ordered enforced. A party's right to seek court enforcement of a deposition subpoena in no way limits the sanctions that may be imposed by the administrative law judge on a party who fails to comply with, or procures a failure to comply with, a subpoena issued under this Section.

§ 747.28 Interlocutory Review.

(a) *General rule.* The NCUA Board may review a ruling of the administrative law judge prior to the certification of the record to the NCUA Board only in accordance with the procedures set forth in this Section and § 747.23.

(b) *Scope of review.* The NCUA Board may exercise interlocutory review of a ruling of the administrative law judge if the NCUA Board finds that:

(1) The ruling involves a controlling question of law or policy as to which substantial grounds exist for a difference of opinion;

(2) Immediate review of the ruling may materially advance the ultimate termination of the proceeding;

(3) Subsequent modification of the ruling at the conclusion of the proceeding would be an inadequate remedy; or

(4) Subsequent modification of the ruling would cause unusual delay or expense.

(c) *Procedure.* Any request for interlocutory review shall be filed by a party with the administrative law judge within ten days of his or her ruling and shall otherwise comply with § 747.23. Any party may file a response to a request for interlocutory review in accordance with § 747.23(d). Upon the expiration of the time for filing all responses, the administrative law judge shall refer the matter to the NCUA Board for final disposition.

(d) *Suspension of proceeding.* Neither a request for interlocutory review nor any disposition of such a request by the NCUA Board under this Section suspends or stays the proceeding unless other wise ordered by the administrative law judge or the NCUA Board.

§ 747.29 Summary Disposition.

(a) *In general.* The administrative law judge shall recommend that the NCUA Board issue a final order granting a motion for summary disposition if the undisputed pleaded facts, admissions, affidavits, stipulations, documentary evidence, matters as to which official notice may be taken, and any other evidentiary materials properly submitted in connection with a motion for summary disposition show that:

(1) There is no genuine issue as to any material fact; and

(2) The moving party is entitled to a decision in its favor as a matter of law.

(b) *Filing of motions and responses.* (1) Any party who believes that there is no genuine issue of material fact to be determined and that he or she is entitled to a decision as a matter of law may move at any time for summary disposition in its favor of all or any part of the proceeding. Any party, within 20 days after service of such a motion, or within such time period as allowed by the administrative law judge, may file a response to such motion.

(2) A motion for summary disposition must be accompanied by a statement of the material

facts as to which the moving party contends there is no genuine issue. Such motion must be supported by documentary evidence, which may take the form of admissions in pleadings, stipulations, depositions, investigatory depositions, transcripts, affidavits and any other evidentiary materials that the moving party contends support his or her position. The motion must also be accompanied by a brief containing the points and authorities in support of the contention of the moving party. Any party opposing a motion for summary disposition must file a statement setting forth those material facts as to which he or she contends a genuine dispute exists. Such opposition must be supported by evidence of the same type as that submitted with the motion for summary disposition and a brief containing the points and authorities in support of the contention that summary disposition would be inappropriate.

(c) *Hearing on motion.* At the request of any party or on his or her own motion, the administrative law judge may hear oral argument on the motion for summary disposition.

(d) *Decision on motion.* Following receipt of a motion for summary disposition and all responses thereto, the administrative law judge shall determine whether the moving party is entitled to summary disposition. If the administrative law judge determines that summary disposition is warranted, the administrative law judge shall submit a recommended decision to that effect to the NCUA Board. If the administrative law judge finds that no party is entitled to summary disposition, he or she shall make a ruling denying the motion.

§ 747.30 Partial Summary Disposition.

If the administrative law judge determines that a party is entitled to summary disposition as to certain claims only, he or she shall defer submitting a recommended decision as to those claims. A hearing on the remaining issues must be ordered. Those claims for which the administrative law judge has determined that summary disposition is warranted will be addressed in the recommended decision filed at the conclusion of the hearing.

§ 747.31 Scheduling and Prehearing Conferences.

(a) *Scheduling conference.* Within 30 days of service of the notice or order commencing a proceeding or such other time as parties may agree, the administrative law judge shall direct counsel for all parties to meet with him or her in person at a specified time and place prior to the hearing or to confer by telephone for the purpose of scheduling the course and conduct of the proceeding. This meeting or telephone conference is called a "scheduling conference." The identification of potential witnesses, the time for and manner of discovery, and the exchange of any prehearing materials including witness lists, statements of issues, stipulations, exhibits and any other materials may also be determined at the scheduling conference.

(b) *Prehearing conferences.* The administrative law judge may, in addition to the scheduling conference, on his or her own motion or at the request of any party, direct counsel for the parties to meet with him or her (in person or by telephone) at a prehearing conference to address any or all of the following:

(1) Simplification and clarification of the issues;

(2) Stipulations, admissions of fact, and the contents, authenticity and admissibility into evidence of documents;

(3) Matters of which official notice may be taken;

(4) Limitation of the number of witnesses;

(5) Summary disposition of any or all issues;

(6) Resolution of discovery issues or disputes;

(7) Amendments to pleadings; and

(8) Such other matters as may aid in the orderly disposition of the proceeding.

(c) *Transcript.* The administrative law judge, in his or her discretion, may require that a scheduling or prehearing conference be recorded by a court reporter. A transcript of the conference and any materials filed, including orders, becomes part of the record of the proceeding. A party may obtain a copy of the transcript at its expense.

(d) *Scheduling or prehearing orders.* At or within a reasonable time following the conclusion of the scheduling conference or any prehearing conference, the administrative law judge shall serve on each party an order setting forth any agreements reached and any procedural determinations made.

§ 747.32 Prehearing Submissions.

(a) Within the time set by the administrative law judge, but in no case later than 14 days before the start of the hearing, each party shall serve on every other party, his or her:

(1) Prehearing statement;

(2) Final list of witnesses to be called to testify at the hearing, including name and address of each witness and a short summary of the expected testimony of each witness;

(3) List of the exhibits to be introduced at the hearing along with a copy of each exhibit; and

(4) Stipulations of fact, if any.

(b) *Effect of failure to comply.* No witness may testify and no exhibits may be introduced at the hearing if such witness or exhibit is not listed in the prehearing submissions pursuant to paragraph (a) of this Section, except for good cause shown.

§ 747.33 Public Hearings.

(a) *General rule.* All hearings shall be open to the public, unless the NCUA Board, in its discretion, determines that holding an open hearing would be contrary to the public interest. Within 20 days of service of the notice, any respondent may file with the NCUA Board a request for a private hearing, and any party may file a reply to such a request. A party must serve on the administrative law judge a copy of any request or reply the party files with the NCUA Board. The form of, and procedure for, these requests and replies are governed by § 747.23. A party's failure to file a request or a reply constitutes a waiver of any objections regarding whether the hearing will be public or private.

(b) *Filing document under seal.* Enforcement Counsel, in his or her discretion, may file any document or part of a document under seal if disclosure of the document would be contrary to the public interest. The administrative law judge shall take all appropriate steps to preserve the confidentiality of such documents or parts thereof, including closing portions of the hearing to the public.

§ 747.34 Hearing Subpoenas.

(a) *Issuance.* (1) Upon application of a party showing general relevance and reasonableness of scope of the testimony or other evidence sought, the administrative law judge may issue a subpoena or a subpoena *duces tecum* requiring the attendance of a witness at the hearing or the production of documentary or physical evidence at the hearing. The application for a hearing subpoena must also contain a proposed subpoena specifying the attendance of a witness or the production of evidence from any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law at any designated place where the hearing is being conducted. The party making the application shall serve a copy of the application and the proposed subpoena on every other party.

(2) A party may apply for a hearing subpoena at any time before the commencement of a hearing. During a hearing, a party may make an application for a subpoena orally on the record before the administrative law judge.

(3) The administrative law judge shall promptly issue any hearing subpoena requested pursuant to this section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon any conditions consistent with this subpart. Upon issuance by the administrative law judge, the party making the application shall serve the subpoena on the person named in the subpoena and on each party.

(b) *Motion to quash or modify.* (1) Any person to whom a hearing subpoena is directed or any party may file a motion to quash or modify the subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant must serve the motion on each party and on the person named in the subpoena. Any party may respond to the motion within ten days of service of the motion.

(2) Any motion to quash or modify a hearing subpoena must be filed prior to the time specified in the subpoena for compliance, but not more than ten days after the date of service of the subpoena upon the movant.

(c) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this Section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may seek enforcement of the subpoena pursuant to § 747.26(c).

§ 747.35 Conduct of Hearings.

(a) *General rules.* (1) Hearings shall be conducted so as to provide a fair and expeditious presentation of the relevant disputed issues. Each party has the right to present its case or defense by oral and documentary evidence and to conduct such cross examination as may be required for full disclosure of the facts.

(2) *Order of hearing.* Enforcement Counsel shall present its case-in-chief first, unless otherwise ordered by the administrative law judge, or unless otherwise expressly specified by law or regulation. Enforcement Counsel shall be the first party to present an opening statement and a closing statement, and may make a rebuttal statement after the respondent's closing statement. If there are multiple respondents, respondents may agree among themselves as to their order of presentation of their cases, but if they do not agree the administrative law judge shall fix the order.

(3) Examination of witnesses. Only one counsel for each party may conduct an examination of a witness, except that in the case of extensive direct examination, the administrative law judge may permit more than one counsel for the party presenting the witness to conduct the examination. A party may have one counsel conduct the direct examination and another counsel conduct re-direct examination of a witness, or may have one counsel conduct the cross examination of a witness and another counsel conduct the re-cross examination of a witness.

(4) *Stipulations.* Unless the administrative law judge directs otherwise, all stipulations of fact and law previously agreed upon by the parties, and all documents, the admissibility of which have been previously stipulated, will be admitted into evidence upon commencement of the hearing.

(b) *Transcript.* The hearing must be recorded and transcribed. The reporter will make the transcript available to any party upon payment by that party to the reporter of the cost of the transcript. The administrative law judge may order the record corrected, either upon motion to correct, upon stipulation of the parties, or following notice to the parties upon the administrative law judge's own motion.

§ 747.36 Evidence.

(a) *Admissibility.* (1) Except as is otherwise set forth in this Section, relevant, material, and reliable evidence that is not unduly repetitive is admissible to the fullest extent authorized by the Administrative Procedure Act and other applicable law.

(2) Evidence that would be admissible under the Federal Rules of Evidence is admissible in a proceeding conducted pursuant to this Subpart.

(3) Evidence that would be inadmissible under the Federal Rules of Evidence may not be deemed or ruled to be inadmissible in a proceeding conducted pursuant to this Subpart if such evidence is relevant, material, reliable and not unduly repetitive.

(b) *Official notice.* (1) Official notice may be taken of any material fact which may be judicially noticed by a United States district court and any material information in the official public records of any Federal or state government agency.

(2) All matters officially noticed by the administrative law judge or NCUA Board shall appear on the record.

(3) If official notice is requested or taken of any material fact, the parties, upon timely request, shall be afforded an opportunity to object.

(c) *Documents.* (1) A duplicate copy of a document is admissible to the same extent as the original, unless a genuine issue is raised as to whether the copy is in some material respect not a true and legible copy of the original.

(2) Subject to the requirements of paragraph (a) of this Section, any document, including a report of examination, supervisory activity, inspection or visitation, prepared by an appropriate Federal financial institution regulatory agency or by a state regulatory agency, is admissible either with or without a sponsoring witness.

(3) Witnesses may use existing or newly created charts, exhibits, calendars, calculations, outlines or other graphic material to summarize, illustrate, or simplify the presentation of testimony. Such materials may, subject to the administrative law judge's discretion, be used with or without being admitted into evidence.

(d) *Objections.* (1) Objections to the admissibility of evidence must be timely made and rulings on all objections must appear on the record.

(2) When an objection to a question or line of questioning propounded to a witness is sustained, the examining counsel may make a specific proffer on the record of what he or she expected to prove by the expected testimony of the witness, either by representation of counsel or by direct interrogation of the witness.

(3) The administrative law judge shall retain rejected exhibits, adequately marked for identification, for the record, and transmit such exhibits to the NCUA Board.

(4) Failure to object to admission of evidence or to any ruling constitutes a waiver of the objection.

(e) *Stipulations.* The parties may stipulate as to any relevant matters of fact or the authentication of any relevant documents. Such stipulations must be received in evidence at a hearing, and are binding on the parties with respect to the matters therein stipulated.

(f) *Depositions of unavailable witnesses.* (1) If a witness is unavailable to testify at a hearing, and that witness has testified in a deposition to which all parties in a proceeding had notice and an opportunity to participate, a party may offer as evidence all or any part of the transcript of the deposition, including deposition exhibits, if any.

(2) Such deposition transcript is admissible to the same extent that testimony would have been admissible had that person testified at the hearing, provided that if a witness refused to answer proper questions during the deposition, the administrative law judge may, on that basis, limit the admissibility of the deposition in any manner that justice requires.

(3) Only those portions of a deposition received in evidence at the hearing constitute a part of the record.

§ 747.37 Post-hearing Filings.

(a) *Proposed findings and conclusions and supporting briefs.* (1) Using the same method of service for each party, the administrative law judge shall serve notice upon each party that the certified transcript, together with all hearing exhibits and exhibits introduced but not admitted into evidence at the hearing, has been filed. Any party may file with the administrative law judge proposed findings of fact, proposed conclusions of law, and a proposed order within 30 days following service of this notice by the administrative law judge or within such longer period as may be ordered by the administrative law judge.

(2) Proposed findings and conclusions must be supported by citation to any relevant authorities and by page references to any relevant portions of the record. A post-hearing brief may be filed in support of proposed findings and conclusions, either as part of the same document or in a separate document. Any party who fails to file timely with the administrative law judge any proposed finding or conclusion is deemed to have waived the right to raise in any subsequent filing or submission any issue not addressed in such party's proposed finding or conclusion.

(b) *Reply briefs.* Reply briefs may be filed within 15 days after the date on which the parties' proposed findings, conclusions, and order are due. Reply briefs must be strictly limited to responding to new matters, issues, or arguments raised in another party's papers. A party who has not filed proposed findings of fact and conclusions of law or a post-hearing brief may not file a reply brief.

(c) *Simultaneous filing required.* The administrative law judge shall not order the filing by any party of any brief or reply brief in advance of the other party's filing of its brief.

§ 747.38 Recommended Decision and Filing of Record.

(a) *Filing of recommended decision and record.* Within 45 days after expiration of the time allowed for filing reply briefs under § 747.37(b), the administrative law judge shall file with and certify to the NCUA Board, for decision, the record of the proceeding. The record must include the administrative law judge's recommended decision, recommended findings of fact, recommended conclusions of law, and proposed order; all prehearing and hearing transcripts, exhibits, and rulings; and the motions, briefs, memoranda, and other supporting papers filed in connection with the hearing. The administrative law judge shall serve upon each party the recommended decision, findings, conclusions, and proposed order.

(b) *Filing of index.* At the same time the administrative law judge files with and certifies to the NCUA Board for final determination the record of the proceeding, the administrative law judge shall furnish to the NCUA Board a certified index of the entire record of the proceeding. The certified

index shall include, at a minimum, an entry for each paper, document or motion filed with the administrative law judge in the proceeding, the date of the filing, and the identity of the filer. The certified index shall also include an exhibit index containing, at a minimum, an entry consisting of exhibit number and title or description for: Each exhibit introduced and admitted into evidence at the hearing; each exhibit introduced but not admitted into evidence at the hearing; each exhibit introduced and admitted into evidence after the completion of the hearing; and each exhibit introduced but not admitted into evidence after the completion of the hearing.

§ 747.39 Exceptions to Recommended Decision.

(a) *Filing exceptions.* Within 30 days after service of the recommended decision, findings, conclusions, and proposed order under § 747.38, a party may file with the NCUA Board written exceptions to the administrative law judge's recommended decision, findings, conclusions or proposed order, to the admission or exclusion of evidence, or to the failure of the administrative law judge to make a ruling proposed by a party. A supporting brief may be filed at the time the exceptions are filed, either as part of the same document or in a separate document.

(b) *Effect of failure to file or raise exceptions.* (1) Failure of a party to file exceptions to those matters specified in paragraph (a) of this Section within the time prescribed is deemed a waiver of objection thereto.

(2) No exception need be considered by the NCUA Board if the party taking exception had an opportunity to raise the same objection, issue, or argument before the administrative law judge and failed to do so.

(c) *Contents.* (1) All exceptions and briefs in support of such exceptions must be confined to the particular matters in, or omissions from, the administrative law judge's recommendations to which that party takes exception.

(2) All exceptions and briefs in support of exceptions must set forth page or paragraph references to the specific parts of the administrative law judge's recommendations to which exception is taken, the page or paragraph references to those portions of the record relied upon to support each exception, and the legal authority relied upon to support each exception.

§ 747.40 Review by the NCUA Board.

(a) *Notice of submission to NCUA Board.* When the NCUA Board determines that the record in the proceeding is complete, the NCUA Board shall serve notice upon the parties that the proceeding has been submitted to the NCUA Board for final decision.

(b) *Oral argument before NCUA Board.* Upon the initiative of the NCUA Board or on the written request of any party filed with the NCUA Board within the time for filing exceptions, the NCUA Board may order and hear oral argument on the recommended findings, conclusions, decision, and order of the administrative law judge. A written request by a party must show good cause for oral argument and state reasons why arguments cannot be presented adequately in writing. A denial of a request for oral argument may be set forth in the NCUA Board's final decision. Oral argument before the NCUA Board must be on the record.

(c) *Final Decision of NCUA Board.* (1) Decisional employees may advise and assist the NCUA Board in the consideration and disposition of the case. The final decision of the NCUA Board will be based upon review of the entire record of the proceeding, except that the NCUA Board may limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties.

(2) The NCUA Board shall render a final decision within 90 days after notification of the parties that the case has been submitted for final decision, or 90 days after oral argument, whichever is later, unless the NCUA Board orders that the action or any aspect thereof be remanded to the administrative law judge for further proceedings. Copies of the final decision and order of the NCUA Board shall be served upon each party to the proceeding, upon other persons required by statute, and, if directed by the NCUA Board or required by statute, upon any appropriate state or Federal supervisory authority.

§ 747.41 Stays Pending Judicial Review.

The commencement of proceedings for judicial review of a final decision and order of the NCUA Board may not, unless specifically ordered by the NCUA Board or a reviewing court, operate as a stay of any order issued by the NCUA Board. The NCUA Board may, in its discretion, and on such terms as it finds just, stay the effectiveness of all or any part of its order pending a final decision on a petition for review of that order.

Subpart B—Local Rules of Practice and Procedure

§ 747.100 Discovery Limitations.

(a) Parties to a proceeding set forth either at § 747.1 of Subpart A or in Subparts C, E or G of this Part may obtain discovery only through the production of documents. No other form of discovery shall be allowed.

(b) In the event that a person producing documents pursuant to a document subpoena is permitted to be deposed, all questioning shall be strictly limited to the identification of documents produced by that person and a reasonable examination to determine whether the subpoenaed person made an adequate search for, and has produced, all subpoenaed documents.

Subpart C—Local Rules and Procedures Applicable to Proceedings for the Involuntary Termination of Insured Status

§ 747.201 Scope.

Under the authority of Section 206(b) of the Act (12 U.S.C. § 1786(b)), the NCUA Board may terminate the insured status of an insured credit union upon the grounds set forth therein and enumerated in § 747.202. The procedure for terminating the insured status of an insured credit union as therein prescribed will be followed and hearings required thereunder will be conducted in accordance with the rules and procedures set forth in this Subpart and Subpart A of this Part. To the extent any rule or procedure of Subpart A is inconsistent with a rule or procedure prescribed in this Subpart C, Subpart C shall control.

§ 747.202 Grounds for Termination of Insurance.

The NCUA Board may institute proceedings to terminate the insured status of an insured credit union whenever it determines that an insured credit union is:

(a) Engaging or has engaged in unsafe or unsound practices in conducting its business;

(b) In an unsafe or unsound condition to continue as an insured credit union; or

(c) Violating or has violated any applicable law, rule, regulation, order, written condition imposed by the NCUA Board in response to any application or request of the credit union, or any written agreement entered into with the NCUA Board.

§ 747.203 Notice of Charges.

(a) Whenever the NCUA Board determines that grounds for termination of insured status exist, it will, for the purpose of securing correction of errant or illegal conditions, serve a Notice of Charges upon the concerned credit union. This Notice will contain a statement describing the unsafe or unsound practices, condition or the relevant violations.

(b) In the case of an insured state-chartered credit union, the NCUA Board shall send a copy of the Notice of Charges to the appropriate state authority, if any, having supervision over the credit union.

§ 747.204 Notice of Intention to Terminate Insured Status.

Unless correction of the practices, condition, or violations set forth in the Notice of Charges is made within 120 days after service of such statement, or within a shorter period of not less than 20 days after such service as the NCUA Board may require in any case where it determines that the insurance risk with respect to such credit union could be unduly jeopardized by further delay or as the appropriate state supervisory authority shall require in the case of an insured state-chartered credit union, the Board, if it determines to proceed further, shall give to the credit union not less than 30 days written notice of its intent to terminate the status of the credit union as an insured credit union. The notice shall contain a statement of the facts constituting the alleged unsafe or unsound practices or condition or violations on which a hearing will be held. Such hearing shall commence not earlier than 30 days nor later than 60 days after the date of service of such notice

upon the credit union, unless an earlier or later date is set by the NCUA Board at the request of the credit union.

§ 747.205 Order Terminating Insured Status.

If, upon the record of the hearing held pursuant to § 747.204, the NCUA Board finds that any unsafe or unsound practice or condition or violation specified in the notice has been established and has not been corrected within the time prescribed under § 747.204, the NCUA Board may issue and serve upon the credit union an order terminating its status as an insured credit union on a date subsequent to the date of such finding and subsequent to the expiration of the time specified in the notice.

§ 747.206 Consent to Termination of Insured Status.

Unless the credit union appears at the hearing designated in the notice of hearing by a duly authorized representative, it will be deemed to have consented to the termination of its status as an insured credit union. In the event the credit union fails to so appear at such hearing, the administrative law judge shall forthwith report the matter to the NCUA Board and the NCUA Board may thereupon issue an order terminating the credit union's insured status.

§ 747.207 Notice of Termination of Insured Status.

Prior to the effective date of the termination of the insured status of an insured credit union under Section 206(b) of the Act (12 U.S.C. § 1786(b)) and at such time as the Board shall specify, the credit union shall mail to each member at his or her last address of record on the books of the credit union, and publish in not less than two issues of a local newspaper of general circulation, notices of the termination of its insured status, and the credit union shall furnish the NCUA Board with proof of publication of such notice. The notice shall be as follows:

NOTICE

(Date)

1. The status of the _____ as an insured credit union under the provision of the Federal Credit Union Act, will terminate as of the close of business on the _____ day of _____ ;

2. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration;

3. Accounts in the credit union on the _____ day of _____ , _____ , up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) year after the close of business on the _____ day of _____ , _____ ; Provided, however, that any withdrawals after the close of business on the _____ day of _____ , _____ , will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)

(Address)

§ 747.208 Duties after Termination.

(a) After the termination of the insured status of any credit union under Section 206(b) of the Act (12 U.S.C. § 1786(b)), insurance of its member accounts to the extent they were insured on the effective date of such termination, less any amounts thereafter withdrawn which reduce the accounts below the amount covered by insurance on the effective date of such termination, shall continue for a period of one year, but no shares issued by the credit union or deposits made after

the date of such termination shall be insured by the NCUA Board.

(b) The credit union shall continue to pay premiums to the NCUA Board during such period and the Board shall have the right to examine the credit union from time to time during the period. The credit union shall, in all other respects, be subject to the duties and obligations of an insured credit union during the one year period. If the credit union is closed for liquidation within this period, the Board shall have the same powers and rights with respect to such credit union as in the case of an insured credit union.

Subpart D—Local Rules and Procedures Applicable to Suspensions and Prohibitions Where Felony Charged

§ 747.301 Scope.

The rules and procedures set forth in this Subpart are applicable to informal proceedings conducted by the NCUA Board, or a Presiding Officer designated by the Board, pursuant to Section 206(i) of the Act (12 U.S.C. § 1786(i)), to suspend, remove and/or prohibit from office or from further participation any institution-affiliated party of an insured credit union who:

(a) is charged in a state, Federal or territorial information or indictment or complaint with committing or participating in a crime involving dishonesty or breach of trust, which crime is punishable by imprisonment for a term exceeding one year under state or Federal law; or

(b) enters a pretrial diversion or other similar program as result of being charged in such information or indictment or complaint with participating or committing such crime; or

(c) is convicted of such crime.

Subpart A of this Part does not apply to proceedings under this Subpart.

§ 747.302 Rules of Practice; Remainder of Board of Directors.

Except as otherwise specifically provided in this Subpart, the following provisions shall apply to proceedings conducted under this Subpart:

(a)(1) *Power of attorney and notice of appearance.* Any person who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia may represent others before the NCUA Board or Presiding Officer designated by the NCUA Board upon filing with the NCUA Board a written declaration that he or she is currently qualified as provided by this paragraph, and is authorized to represent the particular party on whose behalf he acts. Any other person desiring to appear before or transact business with the NCUA Board in a representative capacity may be required to file with the NCUA Board a power of attorney showing his or her authority to act in such capacity, and he or she may be required to show to the satisfaction of the NCUA Board that he or she has the requisite qualifications. Attorneys and representatives of parties to proceedings shall file a written notice of appearance with the NCUA Board or with the Presiding Officer designated by the NCUA Board.

(2) *Summary suspension.* Contemptuous conduct by any person at an argument before the NCUA Board or at the hearing before a Presiding Officer shall be grounds for exclusion therefrom and suspension for the duration of the argument or hearing.

(b)(1) *Notice of hearing.* Whenever a hearing within the scope of this Subpart is ordered by the NCUA Board, a notice of hearing shall be given by the NCUA Board to the party afforded the hearing and to any appropriate state supervisory authority. The notice shall state the time, place, and nature of the hearing and the legal authority and jurisdiction under which the hearing is to be held, and shall contain a statement of the matters of fact or law constituting the grounds for the hearing. It shall be delivered by personal service, by registered or certified mail to the last known address, or by other appropriate means, not later than 30 nor earlier than 60 days before the hearing.

(2) *Party.* The term "party" means a person or agency named or admitted as a party, or any person or agency who has filed a written request and is entitled as of right to be admitted as a party; but a person or agency may be admitted for a limited purpose.

(c)(1) *Computation of time.* In computing any period of time prescribed or allowed by this Subpart, the date of the act, event or default from which the designated period of time begins to run is not to be included. The last day so computed shall be included, unless it is a Saturday, Sunday or legal holiday in the District of Columbia, in which event the period shall run until the end of the next day which is neither a Saturday, Sunday, nor such legal holiday. Intermediate Saturdays, Sundays, and legal holidays shall be in-

cluded in the computation unless the time within which the act is to be performed is ten days or less in which event Saturdays, Sundays, and legal holidays shall not be included.

(2) *Service by mail.* Whenever any party has the right or is required to do some act or take some proceeding, within a period of time prescribed in this Subpart, after the service upon him of any document or other paper of any kind, and such service is made by mail, three days shall be added to the prescribed period from the date when the matter served is deposited in the U.S. mail.

(d) *Nonpublication of submissions.* Unless and until otherwise ordered by the NCUA Board, the notice of hearing, the transcript, written materials submitted during the hearing, the Presiding Officer's recommendation to the NCUA Board and any other papers filed in connection with a hearing under this Subpart, shall not be made public, and shall be for the confidential use only of the NCUA Board, the Presiding Officer, the parties and appropriate authorities.

(e) *Remainder of board of directors.* (1) If at any time, because of the suspension of one or more directors pursuant to this Subpart, there shall be on the board of directors of an insured credit union less than a quorum of directors not so suspended, all powers and functions vested in or exercisable by such board shall vest in and be exercisable by the director or directors on the board not so suspended, until such time as there shall be a quorum on the board of directors.

(2) In the event all of the directors of an insured credit union are suspended pursuant to this Subpart, the NCUA Board shall appoint persons to serve temporarily as directors in their place pending the termination of such suspensions, or until such time as those who have been suspended cease to be directors of the credit union and their respective successors have been elected by the members at an annual or special meeting and have taken office.

(3) Directors appointed temporarily by the NCUA Board pursuant to paragraph (e)(2) of this section, shall, within 30 days following their appointment, call a special meeting for the elec tion of new directors, unless during such 30-day period—

(i) the regular annual meeting is convened; or

(ii) the suspensions giving rise to the appointment of temporary directors are terminated.

§ 747.303 Notice of Suspension or Prohibition.

Whenever an institution-affiliated party of an insured credit union is charged in any state, Federal or territorial information or indictment or complaint with the commission of or participation in a crime involving dishonesty or breach of trust, which crime is punishable by imprisonment for a term exceeding one year under state or Federal law, the NCUA Board may, if continued service or participation by the concerned party may pose a threat to the interests of the credit union's members or may threaten to impair public confidence in the credit union, by written notice served upon such party, suspend him or her from office, or prohibit him or her from further participation in any manner in the affairs of the credit union, or both. A copy of the notice of suspension or prohibition shall also be served upon the credit union. This suspension or prohibition shall remain in effect until such information, indictment, or complaint is finally disposed of, or until such suspension or prohibition is terminated by the NCUA Board.

§ 747.304 Removal or Permanent Prohibition.

In the event that a judgment of conviction or an agreement to enter a pretrial diversion or other similar program is entered against the institution-affiliated party, and at such time as the judgment, if any, is not subject to further appellate review, the NCUA Board may, if continued service or participation by such party may pose a threat to the interests of the credit union's members or may threaten to impair public confidence in the credit union, issue and serve upon the individual an order removing him or her from office or prohibiting him or her from further participation in any manner in the conduct of the affairs of the credit union except with the consent of the NCUA Board. A copy of such order will also be served upon such credit union. A finding of not guilty or other disposition of the charge will not preclude the NCUA Board from thereafter instituting proceedings, pursuant to the provisions of Section 206(g) of the Act (12 U.S.C. 1786(g)) and Subpart A of this Part,

to remove such director, committee member, officer, or other person from office or to prohibit his or her further participation in the affairs of the credit union.

§ 747.305 Effectiveness of Suspension or Removal until Completion of Hearing.

Any notice of suspension or prohibition issued under § 747.303 and any order of removal or prohibition issued under § 747.304 will be effective upon service on the concerned party and will remain effective and outstanding until the completion of any hearing or appeal authorized under Section 206(i) of the Act (12 U.S.C. § 1786(i)) and this Subpart, unless such notice of suspension or order of removal is terminated by the NCUA Board.

§ 747.306 Notice of Opportunity for Hearing.

(a) Any notice of suspension or prohibition issued pursuant to § 747.303, and any order of removal or prohibition issued pursuant to § 747.404, shall be accompanied by a further notice to the concerned individual that he or she may, within 30 days of service of such notice, request in writing an informal hearing at which he or she may present evidence and argument that his or her continued service to or participation in the conduct of the affairs of the credit union does not, or is not likely to, pose a threat to the interests of the credit union's members or threaten to impair confidence in the credit union. Any notice of the opportunity for such a hearing shall be accompanied by a description of the hearing procedure and the criteria to be considered.

(b) A request for a hearing filed pursuant to paragraph (a) of this Section shall state with particularity the relief desired, the grounds therefor, and shall include, when available, supporting evidence. The request and supporting evidence shall be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

§ 747.307 Hearing.

(a) Upon receipt of a request for a hearing which complies with § 747.306, the NCUA Board will order an informal hearing to commence within the following 30 days in Washington, D.C. metropolitan area, or at such other place as the NCUA Board designates, before a Presiding Officer designated by the NCUA Board to conduct the hearing. At the request of the concerned party, the NCUA Board may order the hearing to commence at a time more than 30 days after the receipt of the request for such hearing.

(b) The notice of hearing shall be served by the NCUA Board upon the party or parties afforded the hearing and shall set forth the time and place of the hearing and the name and address of the Presiding Officer.

(c) The subject individual may appear at the hearing personally, through counsel, or personally with counsel. The individual shall have the right to introduce relevant and material written materials (or, at the discretion of the NCUA Board, oral testimony), and to present an oral argument before the Presiding Officer. A member of the enforcement staff of the Office of General Counsel of the NCUA may attend the hearing and may participate as a party. Neither the formal rules of evidence nor the adjudicative procedures of the Administrative Procedure Act (5 U.S.C. 554–557), nor Subpart A of this Part shall apply to the hearing. The proceedings shall be recorded and a transcript furnished to the individual upon request and after the payment of the cost thereof. The NCUA Board shall have the discretion to permit the presentation of witnesses, within specified time limits, so long as a list of such witnesses is furnished to the Presiding Officer at least ten days prior to the hearing. Witnesses shall not be sworn, unless specifically requested by either party or directed by the Presiding Officer. The Presiding Officer may examine any witness and each party shall have the opportunity to cross-examine any witness presented by an opposing party. Upon the request of either the subject individual or the representative of the Office of General Counsel, the record shall remain open for a period of five business days following the hearing, during which time the parties may make any additional submissions to the record. Thereafter, the record shall be closed.

(d) In the course of or in connection with any proceeding under this Subpart, the NCUA Board and the Presiding Officer will have the power to administer oaths and affirmations, to take or cause depositions to be taken, and to issue, revoke, quash, or modify subpoenas and subpoenas duces tecum. If the NCUA Board permits the presentation of witnesses, the NCUA Board or the Presiding Officer may require the attendance of witnesses from any place in any state or in any terri-

tory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. Witnesses subpoenaed shall be paid the same fees and mileage as are paid witnesses in the District Courts of the United States. The NCUA Board or the Presiding Officer may require the production of documents from any place in any such state, territory, or other place.

(e) The Presiding Officer will make his or her recommendations to the Board, where possible, within ten business days following the close of the record.

§ 747.308 Waiver of Hearing; Failure to Request Hearing or Review Based on Written Submissions; Failure to Appear.

(a) The subject individual may, in writing, waive an oral hearing and instead elect to have the matter determined by the NCUA Board on the basis of written submissions alone.

(b) Should any concerned party fail to request in writing an oral hearing or consideration based on written submissions alone within 30 days of service of the notice described in § 747.306, he or she will be deemed to have consented to the NCUA Board's action.

(c) Unless the concerned party appears at the hearing personally or by duly appointed representative, he or she will be deemed to have consented to the NCUA Board's action.

§ 747.309 Decision of the NCUA Board.

Within 60 days following the hearing, or receipt of the subject individual's written submissions where hearing has been waived pursuant to § 747.308, the NCUA Board shall notify the institution-affiliated party whether the suspension or prohibition will be continued, terminated, or otherwise modified, or whether the order of removal or prohibition will be rescinded or otherwise modified. Such notification shall contain a statement of the basis for the decision of the NCUA Board, if that decision is adverse to the respondent party. In the case of a decision favorable to the respondent on the subject of a prior order of removal or prohibition, the NCUA Board shall take prompt action to rescind or otherwise modify the order of removal or prohibition.

§ 747.310 Reconsideration by the NCUA Board.

(a) The subject individual shall have ten business days following receipt of the decision of the NCUA Board in which to petition the NCUA Board for initial reconsideration.

(b) The subject individual also shall be entitled to petition the NCUA Board for reconsideration of its decision any time after the expiration of a 12-month period from the date of the NCUA Board's decision, but no petition for reconsideration may be made within 12 months of a previous petition.

(c) Any petition shall state with particularity the basis for reconsideration, the relief sought, and any exceptions the individual has to the NCUA Board's findings. An individual's petition may be accompanied by a memorandum of points and authorities in support of his or her petition and any supporting documentation the individual may wish to have considered.

(d) No hearing need be granted on such petition for reconsideration. Promptly following receipt of the petition, the Board shall render its decision.

§ 747.311 Relevant Considerations.

In deciding the question of suspension, prohibition, or removal under this Subpart, the NCUA Board will consider the following:

(a) Whether the alleged offense is a crime which is punishable by imprisonment for a term exceeding one year under state or Federal law, and which involves dishonesty or breach of trust;

(b) Whether the continued presence of the subject individual in his or her position may pose a threat to the interests of the credit union's members because of the nature and extent of the individual's participation in the affairs of the insured credit union and/or the nature of the offense with the commission of or participation in which the individual has been charged;

(c) Whether there is cause to believe that there may be an erosion of public confidence in the integrity, safety, or soundness of a particular credit union (either generally or in the particular locality in which the credit union is situated) if the subject individual is permitted to remain in his or her position in an insured credit union;

(d) Whether the individual is covered by the credit union's fidelity bond and, if so, whether the bond is likely to be revoked, or whether coverage under the bond will be affected adversely as a result of the information, indictment, complaint, judgment of conviction or entry into a pretrial diversion or other similar program; and

(e) The NCUA Board may consider any other factors which, in the specific case, appear relevant to the decision to continue in effect, rescind, terminate, or modify a suspension, prohibition, or removal order, except that it shall not consider the ultimate question of the guilt or innocence of the subject individual with regard to the crime with which he or she has been charged.

Subpart E—Local Rules and Procedures Applicable to Proceedings Relating to the Suspension or Revocation of Charters and to Involuntary Liquidations

§ 747.401 Scope.

The rules and procedures set forth in this subpart and Subpart A of this part are applicable to proceedings by the NCUA Board pursuant to section 120(b)(1) of the Act (12 U.S.C. § 1766(b)(1)) to suspend or revoke the charter of a solvent Federal credit union, and to place a solvent Federal credit union into involuntary liquidation. To the extent a rule or procedure set forth in Subpart A of this Part is inconsistent with a rule or procedure set forth in this Subpart E, Subpart E shall control.

§ 747.402 Grounds for Suspension or Revocation of Charter and for Involuntary Liquidation.

(a) *Grounds in general.* The NCUA Board may suspend or revoke the charter of any Federal credit union, and place such credit union into involuntary liquidation and appoint a liquidating agent therefor, upon its finding that the credit union has violated any provision of its charter or bylaws or of the Act or regulations issued thereunder.

(b) *Immediate suspension.* In any case where the Board determines that the grounds set forth in paragraph (a) of this section exist and that immediate action is necessary in order to prevent further dissipation of credit union assets or earnings, or further weakening of the credit union's condition, or to otherwise protect the interest of the credit union's insured members or the National Credit Union Share Insurance Fund, it may order without prior notice the immediate suspension of the charter of such credit union, and if the circumstances so warrant, may take possession of all books, records, assets, and property of every description of such credit union.

§ 747.403 Notice of Intent to Suspend or Revoke Charter; Notice of Suspension.

(a) Upon its determination that one or more of the grounds listed in § 747.402(a) exists, or that because of conditions described in § 747.402(b) immediate suspension of charter is necessary, the NCUA Board shall cause to be served upon that credit union a notice of intent to suspend or revoke charter and of intent to place into involuntary liquidation, or a notice of suspension. Such notice shall contain a statement of the facts which constitute the grounds for the action, a recitation of the options available to the credit union under paragraph (b) of this section, and an explanation of the results that will occur if the credit union fails to exercise said options.

(b) Not later than 40 days after the receipt of the notice provided for in paragraph (a) of this section, the Federal credit union may file with the NCUA Board a statement in writing setting forth the grounds and reasons why its charter should not be suspended or revoked and why it should not be placed into involuntary liquidation; or in lieu of a written statement, request an oral hearing which shall be conducted in accordance with the procedures set forth in this subpart. This statement or request shall be accompanied by a certified copy of a resolution of the board of directors of the Federal credit union concerned authorizing such statement or request, such certification to be made by the president and secretary of the board of directors.

(c) If the Federal credit union concerned does not exercise either alternative available in paragraph (b) of this section within the time required, it shall be deemed to have admitted the facts alleged in the notice and may be deemed to have consented to the relief sought.

§ 747.404 Notice of Hearing.

(a) Upon receipt of a request for hearing which complies with § 747.403(b), the NCUA Board shall transmit the request to the Office of Financial Institution Adjudication ("OFIA"). Such hearing shall commence no earlier than 30 days nor later than 60 days after the date the OFIA receives the request for a hearing, unless an earlier or later date is requested by the Federal credit union concerned and is granted by the NCUA Board in its discretion.

(b) Except as provided in § 747.405(b), the procedures of the Administrative Procedure Act (5 U.S.C. §§ 554–557) and Subpart A of this Part will apply to the hearing.

(c) Unless the Federal credit union shall appear at such hearing by a duly authorized representative, it shall be deemed to have consented to the suspension or revocation of its charter and to the placing of said credit union into involuntary liquidation.

§ 747.405 Issuance of Order.

(a) In the event of such consent as referred to in §§ 747.403(c) or 747.404(c), or if upon the record made at any such hearing as referred to in § 747.403(b), the NCUA Board finds that the charter of the Federal credit union concerned should be suspended or revoked and the credit union closed and placed into involuntary liquidation, it shall cause to be served on such credit union an order directing the suspension or revocation of its charter and directing that it be closed and placed into involuntary liquidation. Such order shall contain a statement of the findings upon which the order is based. Additionally, the NCUA Board shall appoint a liquidating agent or agents.

(b) The NCUA Board shall render its decision and cause such order to be served not later than 45 days after receipt either of consent or of written submissions, as the case may be, or in the case of a formal hearing, after service or the notice of submission referred to in § 747.40(a).

(c) Upon the receipt of a copy of the order which provides that the Federal credit union concerned be placed into involuntary liquidation, the officers and directors of that Federal credit union shall immediately deliver to the agent for the liquidating agent possession and control of all books, records, assets, and property of every description of the Federal credit union, and the agent for the liquidating agent shall proceed to convert said assets to cash, collect all debts due to said Federal credit union and to wind up its affairs in accordance with the provisions of the Act.

§ 747.406 Cancellation of Charter.

Upon the completion of the liquidation and certification by the agent for the liquidating agent that the distribution of the assets of the Federal credit union has been completed, the NCUA Board shall cancel the charter of the Federal credit union concerned.

Subpart F—Local Rules and Procedures Applicable to Proceedings Relating to the Termination of Membership in the Central Liquidity Facility [RESERVED]

Subpart G—Local Rules and Procedures Applicable to Recovery of Attorneys Fees and Other Expenses Under the Equal Access to Justice Act in NCUA Board Adjudications

§ 747.601 Purpose and Scope.

This Subpart contains the regulations of the NCUA implementing the Equal Access to Justice Act (5 U.S.C. § 504), as amended ("EAJA"). The EAJA provides for the award of attorneys fees and other expenses to eligible individuals and entities who are parties to proceedings conducted under this part. An eligible party may receive an award when it prevails over NCUA in a proceeding, or in a significant and discrete substantive portion of the proceeding, unless the position of the NCUA was substantially justified or special circumstances make an award unjust. The rules in this subpart describe the parties eligible for fee awards, explain how to apply for awards and the procedures and standards that NCUA will use to make them. To the extent a rule or procedure set forth in Subpart A of this part is inconsistent with a rule or procedure set forth in this Subpart G, Subpart G will control.

§ 747.602 Eligibility of Applicants.

(a) To be eligible for an award of attorneys fees and expenses, an applicant must be a prevailing party in the proceeding for which it seeks an award and must be:

(1) An individual with a net worth of not more than $2 million;

(2) The sole owner of an unincorporated business who has a net worth of not more than $7 million, including both personal and business interests and not more than 500 employees at the time the proceeding was commenced (an applicant who owns an unincorporated business will be considered as an "individual" rather than a "sole owner of an unincorporated business" if the issues on which the applicant prevails are related primarily to personal interests rather than to business interests);

(3) A charitable or other tax-exempt organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)) with not more than 500 employees;

(4) A cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. § 1141j(a)) with not more than 500 employees; or

(5) Any other partnership, corporation, association, or public or private organization with a net worth of not more than $7 million and not more than 500 employees.

(b) For the purpose of determining eligibility, the net worth of an applicant and the number of employees of an applicant shall be determined as of the date the proceeding was initiated.

(c) The applicant's net worth includes the value of any assets disposed of for the purpose of meeting an eligibility standard and excludes any obligations incurred for this purpose. Transfers of assets or obligations incurred for less than reasonably equivalent value will be presumed to have been made for this purpose.

(d) The employees of an applicant include all persons who regularly perform services for remuneration for the applicant, under the applicant's direction and control; part-time employees shall be included on a proportional basis.

(e) The net worth and number of employees of the applicant and all of its affiliates shall be aggregated to determine eligibility. Any individual, corporation or other entity that directly or indirectly controls or owns a majority of the voting shares or other interest of the applicant, or any corporation or other entity of which the applicant directly or indirectly owns or controls a majority of the voting shares or other interest, will be considered an affiliate for purposes of this subpart, unless the NCUA Board determines that such treatment would be unjust and contrary to the purposes of the EAJA in light of the actual relationship between the affiliated entities. In addition, the NCUA Board may determine that financial relationships of the applicant other than those described in this paragraph constitute special circumstances that would make an award unjust.

(f) An applicant that participates in a proceeding primarily on behalf of one or more other persons or entities that would be ineligible is not itself eligible for an award.

§ 747.603 Prevailing Party.

An eligible applicant may be a "prevailing party" if the applicant wins an action after a full hearing or trial on the merits, if a settlement of the proceeding was effected on terms favorable to it, or if the proceeding against it has been dismissed. In appropriate situations an applicant may also have prevailed if the outcome of the proceeding has substantially vindicated the applicant's position on the significant, substantive matters at issue, even though the applicant has not totally avoided adverse final action.

§ 747.604 Standards for Award.

(a) A prevailing party may receive an award for fees and expenses incurred in connection with a proceeding, or in a significant and discrete substantive portion of the proceeding, by or against NCUA unless the position of NCUA during the proceeding was substantially justified. The burden of proving that an award should not be made is on counsel for NCUA. To avoid an award, counsel for NCUA must show that its position was reasonable in law and in fact.

(b) An award will be reduced or denied if the applicant has unduly or unreasonably protracted the proceeding or if special circumstances make the award sought unjust.

(c) Where an applicant has prevailed on one or more discrete substantive issues in a proceeding, even though all the issues were not resolved in its favor, any award shall be based on the fees and expenses incurred in connection with the discrete significant, substantive issue or issues on which the applicant's position has been upheld. If such segregation of costs is not practicable, the

award may be based on a fair proration of those fees and expenses incurred in the entire proceeding which would be recoverable under this section if proration were not performed.

(d) Whether separate or prorated treatment under the preceding paragraph, including the applicable proration percentage, is appropriate shall be determined on the facts of the particular case. Attention shall be given to the significance and nature of the respective issues and their separability and interrelationship.

§ 747.605 Allowable Fees and Expenses.

(a) Except as provided by § 747.604(b), awards will be based on rates customarily charged by persons engaged in the business of acting as attorneys, agents and expert witnesses, even if the services were made available without charge or at a reduced rate.

(b) No award under this subpart for the fee of an attorney or agent may exceed $75.00 per hour. No award to compensate an expert witness may exceed the highest rate at which NCUA is permitted to pay expert witnesses. However, an award may also include the reasonable expenses of the attorney, agent or witness as a separate item, if the attorney, agent or witness ordinarily charges clients separately for such expenses.

(c) In determining the reasonableness of the fee sought for an attorney, agent, or expert witness, the NCUA Board shall consider the following:

(1) If the attorney, agent, or expert witness is in private practice, his or her customary fee for like services, or, if he or she is an employee of the applicant, the fully allocated cost of the services;

(2) The prevailing rate for similar services in the community in which the attorney, agent, or expert witness ordinarily performs services;

(3) The time actually spent in the representation of the applicant; and

(4) Such other factors as may bear on the value of the services provided.

(d) The reasonable cost of any study, analysis, report, test, project, or similar matter prepared on behalf of the party may be awarded to the extent that the charge for the service does not exceed the prevailing rate for similar services, and the study or other matter was necessary for preparation of the applicant's case.

§ 747.606 Contents of Application.

(a) A prevailing eligible party, as defined in §§ 747.602, 747.603, and 747.604, seeking an award under this section, must file an application for an award of fees and expenses with the Secretary of the NCUA Board. The application shall include the following information:

(1) The identity of the applicant and the proceeding for which an award is sought;

(2) A showing that the applicant has prevailed and an identification of the issues in the proceeding on which the applicant believes that the position of NCUA was not substantially justified;

(3) A statement, with supporting documentation, that the applicant is an eligible party, as defined by § 747.602. If the applicant is an individual, he or she must state that his or her net worth does not exceed $2 million. If the applicant is not an individual, it shall state the number of its employees and that its net worth does not exceed $7 million as of the date the proceeding was initiated. However, an applicant may omit a statement of net worth if:

(i) It attaches a copy of a ruling by the Internal Revenue Service that it qualifies as an organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)) or, in the case of a tax-exempt organization not required to obtain a ruling from the Internal Revenue Service on its exempt status, a statement that describes the basis for the applicant's belief that it qualifies under such section; or

(ii) It states that it is a cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. § 1141j(a)).

(4) A statement of the amount of fees and expenses for which an award is sought; and

(5) Any other matters that the applicant believes may assist or wishes the NCUA Board to consider in determining whether and in what amount an award should be made.

(b) The application shall be signed by the applicant or an authorized officer or attorney of the applicant. It shall also contain or be accompanied by a written verification under oath or under penalty of perjury that the information provided in the application is true and correct.

(c) The application and documentation requirements of this subpart are required by law as a

prerequisite to obtaining a benefit under the Equal Access to Justice Act and this subpart.

§ 747.607 Statement of Net Worth.

(a) Each applicant (other than a qualified tax-exempt organization or cooperative association) must provide a detailed statement showing the net worth of the applicant and any affiliates, as defined in § 747.602(a), when the proceeding was initiated. The exhibit may be in any form convenient to the applicant that provides full disclosure of the applicant's and its affiliates' assets and liabilities and is sufficient to determine whether the applicant is an eligible party. The administrative law judge or the NCUA Board may require additional information from the applicant to determine eligibility. Unless otherwise ordered by the Board or required by law, the statement shall be kept confidential and used by the NCUA Board only in making its determination of an award.

(b) If the applicant or any of its affiliates is a Federal credit union, the portion of the statement of net worth which relates to the Federal credit union shall consist of a copy of the Federal credit union's last Statement of Financial Condition filed before the initiation of the underlying proceeding.

(c) All statements of net worth shall describe any transfers of assets from or obligations incurred by the applicant or any affiliate, occurring in the six-month period prior to the date on which the proceeding was initiated, which reduced the net worth of the applicant and its affiliates below the applicable net worth ceiling. If there were none, the applicant shall so state.

§ 747.608 Documentation of Fees and Expenses.

The application shall be accompanied by full documentation of the fees and expenses, including the cost of any study, analysis, audit, test, project or similar matter, for which an award is sought. A separate, itemized statement shall be submitted for each professional firm or individual whose services are covered by the application, showing hours spent in connection with the proceeding by each individual, a description of the specific services performed, the rate at which each fee has been computed, any expenses for which reimbursement is sought, the total amount claimed, and the total amount paid or payable by the applicant or by any other person or entity for the services provided. The administrative law judge or the NCUA Board may require the applicant to provide vouchers, receipts, or other substantiation for any expenses claimed.

§ 747.609 Filing and Service of Applications.

(a) An application may be filed whenever the applicant has prevailed in the proceeding or in a significant and discrete substantive portion of the proceeding, but in no case later than 30 days after the Board's final disposition of the proceeding.

(b) If review or reconsideration is sought or taken of a decision on which an applicant believes it has prevailed, proceedings for the award of fees shall be stayed pending final disposition of the underlying controversy.

(c) As used in this subpart, final disposition means the issuance of a final order or any other final resolution of a proceeding, such as a settlement or voluntary dismissal.

(d) Any application for an award of fees and expenses shall be filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Any application for an award and any other pleading or document related to an application, shall be filed and served on all parties to the proceeding in the same manner as other pleadings in the proceeding, except as provided in § 747.607(a) for statements of net worth.

§ 747.610 Answer to Application.

(a) Within 30 days after service of an application, counsel for NCUA may file an answer to the application. Unless counsel for NCUA requests and is granted an extension of time for filing or files a statement of intent to negotiate under paragraph (b) of this section, failure to file an answer within the 30-day period will be treated as a consent to the award requested.

(b) If counsel for NCUA and the applicant believe that the issues in the fee application can be settled, they may jointly file a statement of their intent to negotiate a settlement. The filing of this statement shall extend the time for filing an answer for an additional 30 days, and further extensions may be granted by the NCUA Board upon the joint request of counsel for NCUA and the applicant.

(c) The answer shall explain in detail any objections to the award requested and identify the facts

relied on in support of counsel's position. If the answer is based on any alleged facts not already in the record of the proceeding, counsel shall include with the answer a request for further proceedings under § 747.613.

(d)(1) The applicant may file a reply if counsel for NCUA has addressed in his or her answer any of the following issues:

(i) That the position of NCUA in the proceeding was substantially justified;

(ii) That the applicant unduly protracted the proceedings; or

(iii) That special circumstances make an award unjust.

(2) The reply shall be filed within 15 days after service of the answer. If the reply is based on any alleged facts not already in the record of the proceeding, the applicant shall include with the reply a request for further proceedings under § 747.613.

§ 747.611 Comments by Other Parties.

Any party to a proceeding, other than the applicant and counsel for NCUA, may file comments on an application within 30 days after service of the application or on an answer within 15 days after service of the answer. A commenting party may not participate further in proceedings on the application unless the administrative law judge or the NCUA Board determines that the public interest requires such participation in order to permit full exploration of matters raised in the comments.

§ 747.612 Settlement.

The applicant and counsel for NCUA may agree on a proposed settlement of the award before final action on the application, either in connection with a settlement of the underlying proceeding, or after the underlying proceeding has been concluded, in accordance with NCUA's standard settlement procedure. If a prevailing party and counsel for NCUA agree on a proposed settlement of an award before an application has been filed, the application shall be filed with the proposed settlement.

§ 747.613 Further Proceedings.

(a) After the expiration of the time allowed for the filing of all documents necessary for the determination of a recommended fee award, the NCUA Board shall transmit the entire record to the administrative law judge who presided at the underlying proceeding. Ordinarily, the determination of an award will be made on the basis of the written record. However, on request of either the applicant or counsel for NCUA, or on its own initiative, the administrative law judge or the NCUA Board may order further proceedings, such as an informal conference, oral argument, additional written submissions or an evidentiary hearing. Such further proceedings shall be held only when necessary for full and fair resolution of the issues arising from the application, and shall be conducted as promptly as possible.

(b) A request that the administrative law judge or the NCUA Board order further proceedings under this section shall specifically identify the information sought or the disputed issues and shall explain why the additional proceedings are necessary to resolve the issues.

§ 747.614 Recommended Decision.

The administrative law judge shall file a recommended decision on the application with the NCUA Board within 60 days after completion of the proceedings on the application. The recommended decision shall include written findings and conclusions on the applicant's eligibility and status as a prevailing party, and an explanation of the reasons for any difference between the amount requested and the amount awarded. The recommended decision shall also include, if at issue, findings on whether NCUA's position was substantially justified, whether the applicant unduly protracted the proceedings, or whether special circumstances make an award unjust. If the applicant has sought an award against more than one agency, the recommended decision shall allocate responsibility for payment of any award made among the agencies, and shall explain the reasons for the allocation made. The administrative law judge shall file with and certify to the NCUA Board the record of the proceeding on the fee application, the recommended decision and proposed order. Promptly upon such filing, the NCUA Board shall serve upon each party to the proceeding a copy of the administrative law judge's recommended decision, findings, conclusions and proposed order. The provisions of this section and § 747.613 shall not apply, however, in any case where the hearing was held before the NCUA Board.

§ 747.615 Decision of the NCUA Board.

Within 15 days after service of the recommended decision, findings, conclusions, and proposed order, the applicant or counsel for NCUA may file with the NCUA Board written exceptions thereto. A supporting brief may also be filed. The NCUA Board shall render its decision within 60 days

after the matter is submitted to it. The NCUA Board shall furnish copies of its decision and order to the parties. Judicial review of the NCUA Board's final decision and order may be obtained as provided in 5 U.S.C. § 504(c)(2).

§ 747.616 Payment of Award.

An applicant seeking payment of an award granted by the NCUA Board shall submit to the NCUA's Office of the Controller a copy of the NCUA Board's Final Decision and Order granting the award, accompanied by a statement that it will not seek review of the decision and order in the United States court. All submissions shall be addressed to the Office of the Controller, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. The NCUA will pay the amount awarded within 60 days after receiving the applicant's statement, unless judicial review of the award or of the underlying decision of the adversary adjudication has been sought by the applicant or any other party to the proceeding.

Subpart H—Local Rules and Procedures Applicable to Investigations

§ 747.701 Applicability.

The rules in this Subpart apply only to informal and formal investigations conducted by the NCUA Board itself or its delegates. They do not apply to adjudicative or rulemaking proceedings or to routine, periodic or special examinations conducted by the NCUA Board's staff.

§ 747.702 Information Obtained in Investigations.

Information and documents obtained by the Board in the course of any investigation, unless made a matter of public record by the NCUA Board, shall be deemed non-public, but the NCUA Board approves the practice whereby the General Counsel may engage in, and may authorize any person acting on his or her behalf or at his or her direction to engage in, discussions with representatives of domestic or foreign governmental authorities, self-regulatory organizations, and with receivers, trustees, masters and special counsels or special agents appointed by and subject to the supervision of the courts of the United States, concerning information obtained in individual investigations, including investigations conducted pursuant to any order entered by the NCUA Board or its General Counsel pursuant to delegated authority.

§ 747.703 Authority to Conduct Investigations.

(a) The General Counsel and persons acting on his or her behalf and at his or her direction may conduct such investigations into the affairs of any insured credit union or institution-affiliated parties as deemed appropriate to determine whether such credit union or party has violated, is violating or is about to violate any provision of the Act, the NCUA Board's regulations or other relevant statutes or regulations that may bear on a party's fitness to participate in the affairs of a credit union. The General Counsel and persons acting on his or her behalf may investigate whether any party is unfit to participate in the affairs of a credit union, whether formal enforcement proceedings are warranted, or such other matters as the General Counsel or his or her designee, in his or her discretion, shall deem appropriate. Such investigations may be conducted either informally or formally.

(b) Formal investigations involve the exercise of the NCUA Board's subpoena power and are referred to here as formal investigative proceedings. In formal investigative proceedings, the General Counsel and those to whom he or she delegates authority to act on his or her behalf and at his or her direction have augmented investigatory powers and need not rely on the powers available to them in informal investigations, and they may gather evidence through the issuance of subpoenas compelling the production of documents or testimony as well. In informal investigations evidence may be gathered ordinarily through the use of investigatory procedures or credit union examinations and through voluntary statements and submissions.

(c) The NCUA Board has delegated authority to the General Counsel, or designee thereof, to institute formal investigative proceedings by the entry of an order indicating the purpose of the investigation and the designation of persons to conduct that investigation on his or her behalf and at his or her direction. This delegation also extends to the NCUA Board's role as liquidator and conservator of insured credit unions. The power to issue a subpoena may not be delegated outside the agency. The General Counsel may amend such order as he deems appropriate.

Subpart I—Local Rules Applicable to Formal Investigative Proceedings

§ 747.801 Applicability.

The rules in this Subpart are applicable to a witness who is sworn in a formal investigative proceeding. Formal investigative proceedings may be held before the NCUA Board, before one or more of its members, or before any officer designated by the NCUA Board or its General Counsel, as described in Subpart H of this Part, and with or without the assistance of such other counsel as the NCUA Board deems appropriate, for the purpose of taking testimony of witnesses, conducting an investigation and receiving other evidence. The term "officer conducting the investigation" shall mean any of the foregoing.

§ 747.802 Non-public Formal Investigative Proceedings.

Unless otherwise ordered by the NCUA Board, all formal investigative proceedings shall be non-public.

§ 747.803 Subpoenas.

(a) Issuance. In the course of a formal investigative proceeding the officer conducting the investigation may issue a subpoena directing the party named therein to appear before the officer conducting the investigation at a specified time and place to testify or to produce documentary evidence, or both, relating to any matter under investigation.

(b) Service. Service of subpoenas shall be effected in the following manner:

(1) Service upon a natural party. Delivery of a copy of a subpoena to a natural person may be effected by—

(i) handing it to the person;

(ii) leaving it at his or her office with the person in charge thereof or, if there is no one in charge, by leaving it at a conspicuous place there;

(iii) leaving it at his or her dwelling place or usual place of abode with some person of suitable age and discretion who is found there; or

(iv) mailing it by registered or certified mail to him or her at his or her last known address. In the event that personal service as described in this paragraph is impracticable, any other method whereby actual notice is given to the respondent may be employed.

(2) Service upon other persons. When the person to be served is not a natural person, delivery of a copy of the subpoena may be effected by—

(i) handing it to a registered agent for service, or to any officer, director, or agent in charge of any office of such person;

(ii) mailing it by registered or certified mail to any such representative at his or her last known address; or

(iii) any other method whereby actual notice is given to any such representative.

(c) Witness fees and mileage. Witnesses appearing pursuant to subpoena shall be paid the same fees and mileage that are paid to witnesses in the United States district courts. Any such fees and mileage payments need be paid only upon submission of a properly completed application for reimbursement and in no event need they be paid sooner than 30 days after the appearance of the witness pursuant to subpoena.

(d) Enforcement. Whenever it appears to the General Counsel that any person upon whom a subpoena was properly served pursuant to these Rules is refusing to fully comply with the terms of that subpoena, then the General Counsel, in his or her discretion, may apply to the courts of the United States for enforcement of such subpoena.

§ 747.804 Oath; False Statements.

At the discretion of the officer conducting the investigation, testimony of a witness may be taken under oath and administered by the officer. Any person making false statements under oath during the course of a formal investigative proceeding is subject to the criminal penalties for perjury in 18 U.S.C. 1621. Any person who knowingly and willfully makes false and fraudulent statements, whether under oath or otherwise, or who falsifies, conceals or covers up any material fact, or submits any false, fictitious or fraudulent information in connection with such a proceeding, is subject to the criminal penalties set forth in 18 U.S.C. 1001.

§ 747.805 Self-incrimination; Immunity.

(a) Self-incrimination. Except as provided in paragraph (b) of this section, a witness testifying or otherwise giving information in a formal investigative proceeding may refuse to answer questions on the basis of his or her right against self-incrimination granted by the Fifth Amendment of the Constitution of the United States.

(b) Immunity.

(1) No officer conducting any formal investigative proceeding (or any other informal investigation or examination) shall have the power to grant or promise any party any immunity from criminal prosecution under the laws of the United States or of any other jurisdiction.

(2) If the NCUA Board believes that the testimony or other information sought to be obtained from any party may be necessary to the public interest and that party has refused or is likely to refuse to testify or provide other information on the basis of his or her privilege against self-incrimination, the NCUA Board, with the approval of the Attorney General, may issue an order requiring the party to give testimony or provide other information that he or she has previously refused to provide on the basis of self-incrimination.

(3) Whenever a witness refuses, on the basis of his privilege against self-incrimination, to testify or provide other information in a formal investigative proceeding, and the officer conducting the investigation communicates to that person an order of the NCUA Board requiring him or her to testify or provide other information, the witness may not refuse to comply with the order on the basis of his or her privilege against self-incrimination; but no testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information) may be used against the witness in any criminal case, except a prosecution for perjury, giving a false statement, or otherwise failing to comply with the order.

§ 747.806 Transcripts.

Transcripts, if any, of formal investigative proceedings shall be recorded solely by the official reporter, or by any other person or means designated by the officer conducting the investigation. A party who has submitted documentary evidence or testimony in a formal investigative proceeding shall be entitled, upon written request, to procure a copy of his or her documentary evidence or a transcript of his or her testimony on payment of the appropriate fees; provided, however, that in a non-public formal investigative proceeding the NCUA Board may for good cause deny such request or the NCUA Board may place reasonable limitations upon the use of the documentary evidence and transcript. In any event, any witness, upon proper identification, shall have the right to inspect the official transcript of the witness's own testimony.

§ 747.807 Rights of Witnesses.

(a) In the event that a formal investigative proceeding is conducted pursuant to a specific order entered by the NCUA Board or by its General Counsel, then any party who is compelled or requested to provide documentary evidence or testimony as part of such proceeding shall, upon request, be shown a copy of the NCUA Board's or its delegate's order. Copies of such orders shall not be provided for their retention to such persons requesting same except in the sole discretion of the General Counsel or his designee.

(b) Any party compelled to appear, or who appears by request or permission of the officer conducting the investigation, in person at a formal investigative proceeding may be accompanied, represented and advised by counsel who is a member of the bar of the highest court of any state; provided however, that all witnesses in such proceeding shall be sequestered, and unless permitted in the discretion of the officer conducting the investigation, no witness or the counsel accompanying any such witness shall be permitted to be present during the examination of any other witness called in such proceeding.

(c)(1) The right of a witness to be accompanied, represented and advised by counsel shall mean the right to have an attorney present during any formal investigative proceeding and to have the attorney—

(i) advise such person before, during and after such testimony;

(ii) question such person briefly at the conclusion of his testimony to clarify any answers such person has given; and

(iii) make summary notes during such testimony solely for the use of such person.

(2) From time to time, in the discretion of the officer, it shall be necessary for persons other than the witness and his or her counsel to attend nonpublic investigative proceedings. For example, the officer may deem it appropriate that outside counsel to the NCUA Board attend and advise him or her concerning the proceeding including the examination of a particular witness. In these circumstances, outside counsel would not be an officer as that term is used. In other circumstances, it may be appropriate that a technical expert (such as an accountant) accompany the witness and his or

her counsel in order to assist counsel in understanding technical issues. These latter circumstances should be rare, are left to the discretion of the officer conducting the investigation, and shall not in any event be allowed to serve as a ruse to coordinate testimony between witnesses, to oversee or supervise the testimony of any witness, or otherwise defeat the beneficial effects of the witness sequestration rule.

(d) The officer conducting the investigation may report to the NCUA Board any instances where any witness or counsel has been guilty of dilatory, obstructionist or contumacious conduct during the course of a formal investigative proceeding or any other instance of violations of these rules. The NCUA Board will thereupon take such further action as the circumstance may warrant including barring the offending person from further participation in the particular formal investigative proceeding or even from further practice before the Board.

Subpart J—Local Procedures and Standards Applicable to a Notice of Change in Senior Executive Officers, Directors or Committee Members Pursuant to Section 212 of the Act

§ 747.901 Scope.

The rules and procedures set forth in this Subpart shall apply to the notice filed by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, for the consent of the NCUA to add to or replace an individual on the board of directors or supervisory or credit committee, or to employ any individual as a senior executive officer or change the responsibilities of any individual to a position of senior executive officer where the credit union either has been chartered less than 2 years; or is in "troubled condition," as defined in § 701.14 of this Chapter. Subpart A of this Part shall not apply to any proceeding under this Subpart.

§ 747.902 Grounds for Disapproval of Notice.

The NCUA Board or its designee may issue a notice of disapproval with respect to a notice submitted by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, where the competence, experience, character, or integrity of the individual with respect to whom such notice is submitted indicates that it would not be in the best interest of the members of the credit union or the public to permit the individual to be employed by or associated with, such credit union.

§ 747.903 Procedures Where Notice of Disapproval Issued; Reconsideration.

(a) The notice of disapproval shall be served upon the federally insured credit union and the candidate for director, committee member or senior executive officer. The notice of disapproval shall:

(1) Summarize or cite the relevant consideration specified in § 747.902;

(2) Inform the individual and the credit union that, within 15 days of receipt of the notice of disapproval, they can request reconsideration by the Regional Director of the initial determination, or can appeal the determination directly to the NCUA Board;

(3) Specify what additional information, if any, must be considered in the reconsideration.

(b) The request for reconsideration by the Regional Director must be filed at the appropriate Regional Office.

(c) The Regional Director shall act on a request for reconsideration within 30 days of its receipt.

§ 747.904 Appeal.

(a) Time for filing. Within 15 days after issuance of a Notice of Disapproval or a determination on a request for reconsideration by the Regional Director, the individual or credit union (henceforth petitioner) may appeal by filing with the NCUA Board a written request for appeal.

(b) Contents of request. Any appeal must be in writing and include:

(1) The reasons why the NCUA Board should review the disapproval; and

(2) Relevant, substantive and material facts that for good cause were not previously set forth in the notice required to be filed pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter.

(c) Procedures for review of request. Within 30 days of the NCUA Board's receipt of an appeal, the NCUA Board may request in writing that the petitioner submit additional facts and records to support the appeal. The petitioner shall have 15

days from the date of issuance of such written request to provide such additional information. Failure by the petitioner to provide additional information may, as determined solely by the NCUA Board or its designee, result in denial of the petitioner's appeal.

(d) Determination on appeal by NCUA Board or its designee.

(1) Within 90 days from the date of the receipt of an appeal by the NCUA Board or its designee or of its receipt of additional information requested under paragraph (c) of this Section, the NCUA Board or its designee shall notify the petitioner whether the disapproval will be continued, terminated, or otherwise modified. The NCUA Board or its designee shall promptly rescind or modify the notice of disapproval where the decision is favorable to the petitioner.

(2) The determination by the NCUA Board on the appeal shall be provided to the petitioner in writing, stating the basis for any decision of the NCUA Board or its designee that is adverse to the petitioner, and shall constitute a final order of the NCUA Board.

(3) Failure by the NCUA Board to issue a determination on the petitioner's appeal within the 90-day period prescribed under paragraph (d)(1) of this Section shall be deemed a denial of the appeal for purpose of § 747.905.

§ 747.905 Judicial Review.

(a) Failure to file an appeal within the applicable time periods, either to the initial determination or to the decision on request for reconsideration, shall constitute a failure by the petitioner to exhaust available administrative remedies and, due to such failure, any objections to the initial determination or request for reconsideration shall be deemed to be waived and such determination shall be deemed to have been accepted by, and shall be binding upon, the petitioner.

(b) For purposes of seeking judicial review of actions taken pursuant to this Section, suit may be filed in the United States District Court for the district where the requester resides, for the district where the credit union's principal place of business is located, or for the District of Columbia.

Subpart K—Inflation Adjustment of Civil Monetary Penalties

§ 747.1001 Adjustment of civil money penalties by the rate of inflation.

(a) NCUA is required by the Federal Civil Penalties Inflation Adjustment Act of 1990 (Public Law 101–410, 104 Stat. 890, as amended (28 U.S.C. 2461 note)) to adjust the maximum amount of each civil money penalty within its jurisdiction by the rate of inflation. The following chart displays those adjustments, as calculated pursuant to the statute:

U.S. Code citation	CMP description	New maximum amount
(1) 12 U.S.C. 1782(a)(3)	Inadvertent failure to submit a report or the inadvertent submission of a false or misleading report.	$2,200
(2) 12 U.S.C. 1782(a)(3)	Non-inadvertent failure to submit a report or the non-inadvertent submission of a false or misleading report.	$22,000
(3) 12 U.S.C. 1782(a)(3)	Failure to submit a report or the submission of a false or misleading report done knowingly or with reckless disregard.	$1,100,000 or 1 percent of the total assets of the credit union, whichever is less
(4) 12 U.S.C. 1782(d)(2)(A)	First tier	$2,200
(5) 12 U.S.C. 1782(d)(2)(B)	Second tier	$22,000
(6) 12 U.S.C. 1782(d)(2)(C)	Third tier	$1,100,000 or 1 percent of the total assets of the credit union, whichever is less
(7) 12 U.S.C. 1785(e)(3)	Non-compliance with NCUA security regulations	$110
(8) 12 U.S.C. 1786(k)(2)(A)	First tier	$5,500
(9) 12 U.S.C. 1786(k)(2)(B)	Second tier	$27,500

U.S. Code citation	CMP description	New maximum amount
(10) 12 U.S.C. 1786(k)(2)(C)	Third tier	For a person other than an insured credit union: $1,175,000; For an insured credit union: $1,175,000 or 1 percent of the total assets of the credit union, whichever is less
(11) 42 U.S.C. 4012a(f)	Per violation	$385
	Per calendar year	$110,000

(b) The adjustments displayed in paragraph (a) of this section apply to acts occurring beginning on October 23, 2000.

Subpart L—Issuance, Review and Enforcement of Orders Imposing Prompt Corrective Action

§ 747.2001 Scope.

(a) *Independent review process.* The rules and procedures set forth in this subpart apply to federally-insured credit unions, whether federally- or state-chartered (other than corporate credit unions), which are subject to discretionary supervisory actions under part 702 of this chapter, and to reclassification under §§ 702.102(b) and 702.302(d) of this chapter, to facilitate prompt corrective action under section 216 of the Federal Credit Union Act, 12 U.S.C. 1790d; and to senior executive officers and directors of such credit unions who are dismissed pursuant to a discretionary supervisory action imposed under part 702. NCUA staff decisions to impose discretionary supervisory actions under part 702 shall be considered material supervisory determinations for purposes of 12 U.S.C. 1790d(k). Section 747.2002 of this subpart provides an independent appellate process to challenge such decisions.

(b) *Notice to State officials.* With respect to a federally-insured State-chartered credit union under §§ 747.2002, 747.2003 and 747.2004 of this subpart, notices, directives and decisions on appeal served upon a credit union, or a dismissed director or officer thereof, by the NCUA Board shall also be served upon the appropriate State official. Responses, requests for a hearing and to present witnesses, requests to modify or rescind a discretionary supervisory action and requests for reinstatement served upon the NCUA Board by a credit union, or dismissed director or officer thereof, shall also be served upon the appropriate State official.

§ 747.2002 Review of orders imposing discretionary supervisory action.

(a) *Notice of intent to issue directive.*—

(1) *Generally.* Whenever the NCUA Board intends to issue a directive imposing a discretionary supervisory action under §§ 702.202(b), 702.203(b) and 702.204(b) of this chapter on a credit union classified "undercapitalized" or lower, or under §§ 702.304(b) or 702.305(b) of this chapter on a new credit union classified "moderately capitalized" or lower, it must give the credit union prior notice of the proposed action and an opportunity to respond.

(2) *Immediate issuance of directive without notice.* The NCUA Board may issue a directive to take effect immediately under paragraph (a)(1) of this section without notice to the credit union if the NCUA Board finds it necessary in order to carry out the purposes of part 702 of this chapter. A credit union that is subject to a directive which takes effect immediately may appeal the directive in writing to the NCUA Board. Such an appeal must be received by the NCUA Board within 14 calendar days after the directive was issued, unless the NCUA Board permits a longer period. Unless ordered by the NCUA Board, the directive shall remain in effect pending a decision on the appeal. The NCUA Board shall consider any such appeal, if timely filed, within 60 calendar days of receiving it.

(b) *Contents of notice.* The NCUA Board's notice to a credit union of its intention to issue a directive imposing a discretionary supervisory action must state:

(1) The credit union's net worth ratio and net worth category classification;

(2) The specific restrictions or requirements that the NCUA Board intends to impose, and the reasons therefor;

(3) The proposed date when the discretionary supervisory action would take effect and the proposed date for completing the required action or terminating the action; and

(4) That a credit union must file a written response to a notice within 14 calendar days from the date of the notice, or within such shorter period as the NCUA Board determines is appropriate in light of the financial condition of the credit union or other relevant circumstances.

(c) *Contents of response to notice.* A credit union's response to a notice under paragraph (b) of this section must:

(1) Explain why it contends that the proposed discretionary supervisory action is not an appropriate exercise of discretion under this part;

(2) Request the NCUA Board to modify or to not issue the proposed directive;

(3) Include other relevant information, mitigating circumstances, documentation, or other evidence in support of the credit union's position regarding the proposed directive; and

(4) If desired, request the recommendation of NCUA's ombudsman pursuant to paragraph (g) of this section.

(d) *NCUA Board consideration of response.* The NCUA Board, or an independent person designated by the NCUA Board to act on its behalf, after considering a response under paragraph (c) of this section, may:

(1) Issue the directive as originally proposed or as modified;

(2) Determine not to issue the directive and to so notify the credit union; or

(3) Seek additional information or clarification from the credit union or any other relevant source.

(e) *Failure to file response.* A credit union which fails to file a written response to a notice of the NCUA Board's intention to issue a directive imposing a discretionary supervisory action, within the specified time period, shall be deemed to have waived the opportunity to respond, and to have consented to the issuance of the directive.

(f) *Request to modify or rescind directive.* A credit union that is subject to an existing directive imposing a discretionary supervisory action may request in writing that the NCUA Board reconsider the terms of the directive, or rescind or modify it, due to changed circumstances. Unless otherwise ordered by the NCUA Board, the directive shall remain in effect while such request is pending. A request under this paragraph which remains pending 60 days following receipt by the NCUA Board is deemed granted.

(g) *Ombudsman.* A credit union may request in writing the recommendation of NCUA's ombudsman to modify or to not issue a proposed directive under paragraph (b) of this section, or to modify or rescind an existing directive due to changed circumstances under paragraph (f) of this section. A credit union which fails to request the ombudsman's recommendation in a response under paragraph (c) of this section, or in a request under paragraph (f) of this section, shall be deemed to have waived the opportunity to do so. The ombudsman shall promptly notify the credit union and the NCUA Board of his or her recommendation.

§ 747.2003 Review of order reclassifying a credit union on safety and soundness criteria.

(a) *Notice of proposed reclassification based on unsafe or unsound condition or practice.* When the NCUA Board proposes to reclassify a credit union or subject it to the supervisory actions applicable to the next lower net worth category pursuant to §§ 702.102(b) and 702.302(d) of this chapter (each such action hereinafter referred to as "reclassification"), the NCUA Board shall issue and serve on the credit union reasonable prior notice of the proposed reclassification.

(b) *Contents of notice.* A notice of intention to reclassify a credit union based on unsafe or unsound condition or practice shall state:

(1) The credit union's net worth ratio, current net worth category classification, and the net worth category to which the credit union would be reclassified;

(2) The unsafe or unsound practice(s) and/or condition(s) justifying reasons for reclassification of the credit union;

(3) The date by which the credit union must file a written response to the notice (including a request for a hearing), which date shall be no less than 14 calendar days from the date of service of the notice unless the NCUA Board determines that a shorter period is appropriate in light of the financial condition of the credit union or other relevant circumstances; and

(4) That a credit union which fails to—

(i) File a written response to the notice of reclassification, within the specified time period, shall be deemed to have waived the opportunity to respond, and to have consented to reclassification;

(ii) Request a hearing shall be deemed to have waived any right to a hearing; and

(iii) Request the opportunity to present witness testimony shall be deemed have waived any right to present such testimony.

(c) *Contents of response to notice.* A credit union's response to a notice under paragraph (b) of this section must:

(1) Explain why it contends that the credit union should not be reclassified;

(2) Include any relevant information, mitigating circumstances, documentation, or other evidence in support of the credit union's position;

(3) If desired, request an informal hearing before the NCUA Board under this section; and

(4) If a hearing is requested, identify any witness whose testimony the credit union wishes to present and the general nature of each witness's expected testimony.

(d) *Order to hold informal hearing.* Upon timely receipt of a written response that includes a request for a hearing, the NCUA Board shall issue an order commencing an informal hearing no later than 30 days after receipt of the request, unless the credit union requests a later date. The hearing shall be held in Alexandria, Virginia, or at such other place as may be designated by the NCUA Board, before a presiding officer designated by the NCUA Board to conduct the hearing and to recommend a decision.

(e) *Procedures for informal hearing.*—(1) The credit union may appear at the hearing through a representative or through counsel. The credit union shall have the right to introduce relevant documents and to present oral argument at the hearing. The credit union may introduce witness testimony only if expressly authorized by the NCUA Board or the presiding officer. Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure (12 CFR part 747) shall apply to an informal hearing under this section unless the NCUA Board orders otherwise.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the credit union upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or by the presiding officer. The presiding officer may ask questions of any witness.

(3) The presiding officer may order that the hearing be continued for a reasonable period following completion of witness testimony or oral argument to allow additional written submissions to the hearing record.

(4) Within 20 calendar days following the closing of the hearing and the record, the presiding officer shall make a recommendation to the NCUA Board on the proposed reclassification.

(f) *Time for final decision.* Not later than 60 calendar days after the date the record is closed, or the date of receipt of the credit union's response in a case where no hearing was requested, the NCUA Board will decide whether to reclassify the credit union, and will notify the credit union of its decision. The decision of the NCUA Board shall be final.

(g) *Request to rescind reclassification.* Any credit union that has been reclassified under this section may file a written request to the NCUA Board to reconsider or rescind the reclassification, or to modify, rescind or remove any directives issued as a result of the reclassification. Unless otherwise ordered by the NCUA Board, the credit union shall remain reclassified, and subject to any directives issued as a result, while such request is pending.

(h) *Non-delegation*. The NCUA Board may not delegate its authority to reclassify a credit union into a lower net worth category or to treat a credit union as if it were in a lower net worth category pursuant to §§ 702.102(b) or 702.302(d) of this chapter.

§ 747.2004 Review of order to dismiss a director or senior executive officer.

(a) *Service of directive to dismiss and notice.* When the NCUA Board issues and serves a directive on a credit union requiring it to dismiss from office any director or senior executive officer under §§ 702.202(b)(7), 702.203(b)(8), 702.204(b)(8), 702.304(b) or 702.305(b) of this chapter, the NCUA Board shall also serve upon the person the credit union is directed to dismiss (Respondent) a copy of the directive (or the relevant portions, where appropriate) and notice of the Respondent's right to seek reinstatement.

(b) *Contents of notice of right to seek reinstatement.* A notice of a Respondent's right to seek reinstatement shall state:

(1) That a request for reinstatement (including a request for a hearing) shall be filed with the NCUA Board within 14 calendar days after the Respondent receives the directive and notice under paragraph (a) of this section,

unless the NCUA Board grants the Respondent's request for further time;

(2) The reasons for dismissal of the Respondent; and

(3) That the Respondent's failure to—

(i) Request reinstatement shall be deemed a waiver of any right to seek reinstatement;

(ii) Request a hearing shall be deemed a waiver of any right to a hearing; and

(iii) Request the opportunity to present witness testimony shall be deemed a waiver of the right to present such testimony.

(c) *Contents of request for reinstatement.* A request for reinstatement in response to a notice under paragraph (b) of this section must:

(1) Explain why the Respondent should be reinstated;

(2) Include any relevant information, mitigating circumstances, documentation, or other evidence in support of the Respondent's position;

(3) If desired, request an informal hearing before the NCUA Board under this section; and

(4) If a hearing is requested, identify any witness whose testimony the Respondent wishes to present and the general nature of each witness's expected testimony.

(d) *Order to hold informal hearing.* Upon receipt of a timely written request from a Respondent for an informal hearing on the portion of a directive requiring a credit union to dismiss from office any director or senior executive officer, the NCUA Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the Respondent requests a later date. The hearing shall be held in Alexandria, Virginia, or at such other place as may be designated by the NCUA Board, before a presiding officer designated by the NCUA Board to conduct the hearing and recommend a decision.

(e) *Procedures for informal hearing.*— (1) A Respondent may appear at the hearing personally or through counsel. A Respondent shall have the right to introduce relevant documents and to present oral argument at the hearing. A Respondent may introduce witness testimony only if expressly authorized by the NCUA Board or by the presiding officer. Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure (12 CFR part 747) apply to an informal hearing under this section unless the NCUA Board orders otherwise.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer. The presiding officer may ask questions of any witness.

(3) The presiding officer may order that the hearing be continued for a reasonable period following completion of witness testimony or oral argument to allow additional written submissions to the hearing record.

(4) A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the credit union would materially strengthen the credit union's ability to—

(i) Become "adequately capitalized," to the extent that the directive was issued as a result of the credit union's net worth category classification or its failure to submit or implement a net worth restoration plan or revised business plan; and

(ii) Correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of reclassification of the credit union pursuant to §§702.102(b) and 702.302(d) of this chapter.

(5) Within 20 calendar days following the date of closing of the hearing and the record, the presiding officer shall make a recommendation to the NCUA Board concerning the Respondent's request for reinstatement with the credit union.

(f) *Time for final decision.* Not later than 60 calendar days after the date the record is closed, or the date of the response in a case where no hearing was requested, the NCUA Board shall grant or deny the request for reinstatement and shall notify the Respondent of its decision. If the NCUA Board denies the request for reinstatement, it shall set forth in the notification the reasons for its decision. The decision of the NCUA Board shall be final.

(g) *Effective date.* Unless otherwise ordered by the NCUA Board, the Respondent's dismissal shall take and remain in effect pending a final decision on the request for reinstatement.

§ 747.2005 Enforcement of orders.

(a) *Judicial remedies.* Whenever a credit union fails to comply with a directive imposing a discretionary supervisory action, or enforcing a manda-

unless the NCUA Board grants the Respondent's request for further time;

(2) The reasons for dismissal of the Respondent; and

(3) That the Respondent's failure to—

(i) Request reinstatement shall be deemed a waiver of any right to seek reinstatement;

(ii) Request a hearing shall be deemed a waiver of any right to a hearing; and

(iii) Request the opportunity to present witness testimony shall be deemed a waiver of the right to present such testimony.

(c) *Contents of request for reinstatement.* A request for reinstatement in response to a notice under paragraph (b) of this section must:

(1) Explain why the Respondent should be reinstated;

(2) Include any relevant information, mitigating circumstances, documentation, or other evidence in support of the Respondent's position;

(3) If desired, request an informal hearing before the NCUA Board under this section; and

(4) If a hearing is requested, identify any witness whose testimony the Respondent wishes to present and the general nature of each witness's expected testimony.

(d) *Order to hold informal hearing.* Upon receipt of a timely written request from a Respondent for an informal hearing on the portion of a directive requiring a credit union to dismiss from office any director or senior executive officer, the NCUA Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the Respondent requests a later date. The hearing shall be held in Alexandria, Virginia, or at such other place as may be designated by the NCUA Board, before a presiding officer designated by the NCUA Board to conduct the hearing and recommend a decision.

(e) *Procedures for informal hearing.*— (1) A Respondent may appear at the hearing personally or through counsel. A Respondent shall have the right to introduce relevant documents and to present oral argument at the hearing. A Respondent may introduce witness testimony only if expressly authorized by the NCUA Board or by the presiding officer. Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure (12 CFR part 747) apply to an informal hearing under this section unless the NCUA Board orders otherwise.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer. The presiding officer may ask questions of any witness.

(3) The presiding officer may order that the hearing be continued for a reasonable period following completion of witness testimony or oral argument to allow additional written submissions to the hearing record.

(4) A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the credit union would materially strengthen the credit union's ability to—

(i) Become "adequately capitalized," to the extent that the directive was issued as a result of the credit union's net worth category classification or its failure to submit or implement a net worth restoration plan or revised business plan; and

(ii) Correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of reclassification of the credit union pursuant to §§702.102(b) and 702.302(d) of this chapter.

(5) Within 20 calendar days following the date of closing of the hearing and the record, the presiding officer shall make a recommendation to the NCUA Board concerning the Respondent's request for reinstatement with the credit union.

(f) *Time for final decision.* Not later than 60 calendar days after the date the record is closed, or the date of the response in a case where no hearing was requested, the NCUA Board shall grant or deny the request for reinstatement and shall notify the Respondent of its decision. If the NCUA Board denies the request for reinstatement, it shall set forth in the notification the reasons for its decision. The decision of the NCUA Board shall be final.

(g) *Effective date.* Unless otherwise ordered by the NCUA Board, the Respondent's dismissal shall take and remain in effect pending a final decision on the request for reinstatement.

§ 747.2005 Enforcement of orders.

(a) *Judicial remedies.* Whenever a credit union fails to comply with a directive imposing a discretionary supervisory action, or enforcing a manda-

tory supervisory action under part 702 of this chapter, the NCUA Board may seek enforcement of the directive in the appropriate United States District Court pursuant to 12 U.S.C. 1786(k)(1).

(b) *Administrative remedies*—(1) *Failure to comply with directive.* Pursuant to 12 U.S.C. 1786(k)(2)(A), the NCUA Board may assess a civil money penalty against any credit union that violates or otherwise fails to comply with any final directive issued under part 702 of this chapter, or against any institution-affiliated party of a credit union (per 12 U.S.C. 1786(r)) who participates in such violation or noncompliance.

(2) *Failure to implement plan.* Pursuant to 12 U.S.C. 1786(k)(2)(A), the NCUA Board may assess a civil money penalty against a credit union which fails to implement a net worth restoration plan under subpart B of part 702 of this chapter or a revised business plan under subpart C of part 702, regardless whether the plan was published.

(c) *Other enforcement action.* In addition to the actions described in paragraphs (a) and (b) of this section, the NCUA Board may seek enforcement of the directives issued under part 702 of this chapter through any other judicial or administrative proceeding authorized by law.

Part 748

Security Program, Report of Crime and Catastrophic Act and Bank Secrecy Act Compliance

§ 748.0 Security program.

(a) Each federally-insured credit union will develop a written security program within 90 days of the effective date of insurance.

(b) The security program will be designed to:

(1) Protect each credit union office from robberies, burglaries, larcenies, and embezzlement;

(2) Ensure the security and confidentiality of member records, protect against anticipated threats or hazards to the security or integrity of such records, and protect against unauthorized access to or use of such records that could result in substantial harm or serious inconvenience to a member;

(3) Assist in the identification of persons who commit or attempt such actions and crimes; and

(4) Prevent destruction of vital records, as defined in 12 CFR part 749.

§ 748.1 Filing of reports.

(a) *Compliance Report.* Each federally-insured credit union shall file with the regional director an annual statement certifying its compliance with the requirements of this Part. The statement shall be dated and signed by the president or other managing officer of the credit union. The statement is contained on the Report of Officials which is submitted annually by federally-insured credit unions after the election of officials. In the case of federally-insured state-chartered credit unions, this statement can be mailed to the regional director via the state supervisory authority, if desired. In any event, a copy of the statement shall always be sent to the appropriate state supervisory authority.

(b) *Catastrophic Act Report.* Each federally-insured credit union will notify the regional director within 5 business days of any catastrophic act that occurs at its office(s). A catastrophic act is any natural disaster such as a flood, tornado, earthquake, etc., or major fire or other disaster resulting in some physical destruction or damage to the credit union. Within a reasonable time after a catastrophic act occurs, the credit union shall ensure that a record of the incident is prepared and filed at its main office. In the preparation of such record, the credit union should include information sufficient to indicate the office where the catastrophic act occurred; when it took place; the amount of the loss, if any; whether any operational or mechanical deficiency(ies) might have contributed to the catastrophic act; and what has been done or is planned to be done to correct the deficiency(ies).

(c) *Suspicious Activity Report.* (1) Each federally-insured credit union will report any crime or suspected crime that occurs at its office(s), utilizing NCUA Form 2362, Suspicious Activity Report (SAR), within thirty calendar days after discovery. Each federally-insured credit union must follow the instructions and reporting requirements accompanying the SAR. Copies of the SAR may be obtained from the appropriate NCUA Regional Office.

(2) Each federally-insured credit union shall maintain a copy of any SAR that it files and the original of all attachments to the report for a period of five years from the date of the report, unless the credit union is informed in writing by the National Credit Union Administration that the materials may be discarded sooner.

(3) Failure to file a SAR in accordance with the instructions accompanying the report may subject the federally-insured credit union, its officers, directors, agents or other institution-affiliated parties to the assessment of civil money penalties or other administrative actions.

(4) Filing of Suspicious Activity Reports will ensure that law enforcement agencies and NCUA are promptly notified of actual or suspected crimes. Information contained on SARs will be entered into an interagency database and will assist the federal government in taking appropriate action.

§ 748.2 Procedures for monitoring Bank Secrecy Act (BSA) compliance.

(a) *Purpose.* This Section is issued to ensure that all federally-insured credit unions establish and maintain procedures reasonably designed to

assure and monitor compliance with the requirements of Subchapter II of Chapter 53 of Title 31, United States Code, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, and the implementing regulations promulgated thereunder by the Department of Treasury, 31 C.F.R. Part 103.

(b) *Establishment of a BSA compliance program.* (1) *Program requirement.* Each federally-insured credit union shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and recording requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program must be written, approved by the credit union's board of directors, and reflected in the minutes of the credit union.

(2) *Customer identification program.* Each federally-insured credit union is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the NCUA and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.

(c) *Contents of Compliance Program.* Such compliance program shall at a minimum—

(1) Provide for a system of internal controls to assure ongoing compliance;

(2) Provide for independent testing for compliance to be conducted by credit union personnel or outside parties;

(3) Designate an individual responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide training for appropriate personnel.

Appendix A to Part 748—Guidelines for Safeguarding Member Information

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I. Introduction

The Guidelines for Safeguarding Member Information (Guidelines) set forth standards pursuant to sections 501 and 505(b), codified at 15 U.S.C. 6801 and 6805(b), of the Gramm-Leach-Bliley Act. These Guidelines provide guidance standards for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of member information.

A. *Scope.* The Guidelines apply to member information maintained by or on behalf of federally-insured credit unions. Such entities are referred to in this appendix as "the credit union."

B. *Definitions.* 1. *In general.* Except as modified in the Guidelines or unless the context otherwise requires, the terms used in these Guidelines have the same meanings as set forth in 12 CFR part 716.

2. For purposes of the Guidelines, the following definitions apply:

a. *Member* means any member of the credit union as defined in 12 CFR 716.3(n).

b. *Member information* means any records containing nonpublic personal information, as defined in 12 CFR 716.3(q), about a member, whether in paper, electronic, or other form, that is maintained by or on behalf of the credit union.

c. *Member information system* means any method used to access, collect, store, use, transmit, protect, or dispose of member information.

d. *Service provider* means any person or entity that maintains, processes, or otherwise is permitted access to member information through its provision of services directly to the credit union.

II. Standards for Safeguarding Member Information

A. *Information Security Program.* A comprehensive written information security program includes administrative, technical, and physical safeguards appropriate to the size and complexity of the credit union and the nature and scope of its activities. While all parts of the credit union are not required to implement a uniform set of policies, all elements of the information security program must be coordinated.

B. *Objectives.* A credit union's information security program should be designed to: ensure the security and confidentiality of member information; protect against any anticipated threats or hazards to the security or integrity of such information; and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any member. Protecting confidentiality includes honoring members' requests to opt out of disclosures to nonaffiliated third parties, as described in 12 CFR 716.1(a)(3).

III. Development and Implementation of Member Information Security Program

A. *Involve the Board of Directors.* The board of directors or an appropriate committee of the board of each credit union should:

1. Approve the credit union's written information security policy and program; and

2. Oversee the development, implementation, and maintenance of the credit union's information security program, including assigning specific responsibility for its implementation and reviewing reports from management.

B. *Assess Risk.* Each credit union should:

1. Identify reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of member information or member information systems;

2. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of member information; and

3. Assess the sufficiency of policies, procedures, member information systems, and other arrangements in place to control risks.

C. *Manage and Control Risk.* Each credit union should:

1. Design its information security program to control the identified risks, commensurate with the sensitivity of the information as well as the complexity and scope of the credit union's activities. Each credit union must consider whether the following security measures are appropriate for the credit union and, if so, adopt those measures the credit union concludes are appropriate:

a. Access controls on member information systems, including controls to authenticate and permit access only to authorized individuals and controls to prevent employees from providing member information to unauthorized individuals who may seek to obtain this information through fraudulent means;

b. Access restrictions at physical locations containing member information, such as buildings, computer facilities, and records storage facilities to permit access only to authorized individuals;

c. Encryption of electronic member information, including while in transit or in storage on networks or systems to which unauthorized individuals may have access;

d. Procedures designed to ensure that member information system modifications are consistent with the credit union's information security program;

e. Dual controls procedures, segregation of duties, and employee background checks for employees with responsibilities for or access to member information;

f. Monitoring systems and procedures to detect actual and attempted attacks on or intrusions into member information systems;

g. Response programs that specify actions to be taken when the credit union suspects or detects that unauthorized individuals have gained access to member information systems, including appropriate reports to regulatory and law enforcement agencies; and

h. Measures to protect against destruction, loss, or damage of member information due to potential environmental hazards, such as fire and water damage or technical failures.

2. Train staff to implement the credit union's information security program.

3. Regularly test the key controls, systems and procedures of the information security program. The frequency and nature of such tests should be determined by the credit union's risk assessment. Tests should be conducted or reviewed by independent third parties or staff independent of those that develop or maintain the security programs.

D. *Oversee Service Provider Arrangements.* Each credit union should:

1. Exercise appropriate due diligence in selecting its service providers;

2. Require its service providers by contract to implement appropriate measures designed to meet the objectives of these guidelines; and

3. Where indicated by the credit union's risk assessment, monitor its service providers to confirm that they have satisfied their obligations as required by paragraph D.2. As part of this monitoring, a credit union should review audits, summaries of test results, or other equivalent evaluations of its service providers.

E. *Adjust the Program.* Each credit union should monitor, evaluate, and adjust, as appropriate, the information security program in light of any relevant changes in technology, the sensitivity of its member information, internal or external threats to information, and the credit union's own changing business arrangements, such as mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, and changes to member information systems.

F. *Report to the Board.* Each credit union should report to its board or an appropriate committee of the board at least annually. This report should describe the overall status of the information security program and the credit union's compliance with these guidelines. The report should discuss material matters related to its program, addressing issues such as: risk assessment; risk management and control decisions; service provider arrangements; results of testing; security breaches or violations and management's responses; and recommendations for changes in the information security program.

G. *Implement the Standards.*

1. *Effective date.* Each credit union must implement an information security program pursuant to the objectives of these Guidelines by July 1, 2001.

2. *Two-year grandfathering of agreements with service providers.* Until July 1, 2003, a contract that a credit union has entered into with

a service provider to perform services for it or functions on its behalf satisfies the provisions of paragraph III.D., even if the contract does not include a requirement that the servicer maintain the security and confidentiality of member information, as long as the credit union entered into the contract on or before March 1, 2001.

Part 749

Records Preservation Program and Record Retention Appendix

§ 749.0 What is covered in this part?

This part describes the obligations of all federally insured credit unions to maintain a records preservation program to identify, store and reconstruct vital records in the event that the credit union's records are destroyed. It establishes flexibility in the format credit unions may use for maintaining writings, records or information required by other NCUA regulations. The appendix also provides guidance concerning the appropriate length of time credit unions should retain various types of operational records.

§ 749.1 What are vital records?

Vital records include at least the following records, as of the most recent month-end:

(a) A list of share, deposit, and loan balances for each member's account which:

(1) Shows each balance individually identified by a name or number;

(2) Lists multiple loans of one account separately; and

(3) Contains information sufficient to enable the credit union to locate each member, such as address and telephone number, unless the board of directors determines that the information is readily available from another source.

(b) A financial report, which lists all of the credit union's asset and liability accounts and bank reconcilements.

(c) A list of the credit union's financial institutions, insurance policies, and investments. This information may be marked "permanent" and stored separately, to be updated only when changes are made.

§ 749.2 What must a credit union do with vital records?

The board of directors of a credit union is responsible for establishing a vital records preservation program within 6 months after its insurance certificate is issued. The vital records preservation program must contain procedures for storing duplicate vital records at a vital records center and must designate the staff member responsible for carrying out the vital records duties. Records must be stored every 3 months, within 30 days after the end of the 3-month period. Previously stored records may be destroyed when the current records are stored. The credit union must also maintain a records preservation log showing what records were stored, where the records were stored, when the records were stored, and who sent the records for storage. Credit unions, which have some or all of their records maintained by an off-site data processor, are considered to be in compliance for the storage of those records.

§ 749.3 What is a vital records center?

A vital records center is defined as a storage facility at any location far enough from the credit union's offices to avoid the simultaneous loss of both sets of records in the event of disaster.

§ 749.4 What format may the credit union use for preserving records?

Preserved records may be in any format that can be used to reconstruct the credit union's records. Formats include paper originals, machine copies, micro-film or fiche, magnetic tape, or any electronic format that accurately reflects the information in the record, remains accessible to all persons who are entitled to access by statute, regulation or rule of law, and is capable of being reproduced by transmission, printing or otherwise.

§ 749.5 What format may credit unions use for maintaining writings, records or information required by other NCUA regulations?

Various NCUA regulations require credit unions to maintain certain writings, records or information. Credit unions may use any format, electronic or other, for maintaining the writings, records or information that accurately reflects the

information, remains accessible to all persons who are entitled to access by statute, regulation or rule of law, and is capable of being reproduced by transmission, printing or otherwise. The credit union must maintain the necessary equipment or software to permit an examiner access to the records during the examination process.

Appendix A to Part 749—Record Retention Guidelines

Credit unions often look to NCUA for guidance on the appropriate length of time to retain various types of operational records. NCUA does not regulate in this area, but as an aid to credit unions it is publishing this appendix of suggested guidelines for record retention. NCUA recognizes that credit unions must strike a balance between the competing demands of space, resource allocation and the desire to retain all the records that they may need to conduct their business successfully. Efficiency requires that all records that are no longer useful be discarded, just as both efficiency and safety require that useful records be preserved and kept readily available.

A. What Format Should the Credit Union Use for Retaining Records?

NCUA does not recommend a particular format for record retention. If the credit union stores records on microfilm, microfiche, or in an electronic format, the stored records must be accurate, reproducible and accessible to an NCUA examiner. If records are stored on the credit union premises, they should be immediately accessible upon the examiner's request; if records are stored by a third party or off-site, then they should be made available to the examiner within a reasonable time after the examiner's request. The credit union must maintain the necessary equipment or software to permit an examiner to review and reproduce stored records upon request. The credit union should also ensure that the reproduction is acceptable for submission as evidence in a legal proceeding.

B. Who Is Responsible for Establishing a System for Record Disposal?

The credit union's board of directors may approve a schedule authorizing the disposal of certain records on a continuing basis upon expiration of specified retention periods. A schedule provides a system for disposal of records and eliminates the need for board approval each time the credit union wants to dispose of the same types of records created at different times.

C. What Procedures Should a Credit Union Follow When Destroying Records?

The credit union should prepare an index of any records destroyed and retain the index permanently. Destruction of records should ordinarily be carried out by at least two persons whose signatures, attesting to the fact that records were actually destroyed, should be affixed to the listing.

D. What Are the Recommended Minimum Retention Times?

Record destruction may impact the credit union's legal standing to collect on loans or defend itself in court. Since each state can impose its own rules, it is prudent for a credit union to consider consulting with local counsel when setting minimum retention periods. A record pertaining to a member's account that is not considered a vital record may be destroyed once it is verified by the supervisory committee. Individual Share and Loan Ledgers should be retained permanently. Records, for a particular period, should not be destroyed until both a comprehensive annual audit by the supervisory committee and a supervisory examination by the NCUA have been made for that period.

E. What Records Should Be Retained Permanently?

1. Official records of the credit union that should be retained permanently are:

(a) Charter, bylaws, and amendments.

(b) Certificates or licenses to operate under programs of various government agencies, such as a certificate to act as issuing agent for the sale of U.S. savings bonds.

(c) Current manuals, circular letters and other official instructions of a permanent character received from the NCUA and other governmental agencies.

2. Key operational records that should be retained permanently are:

(a) Minutes of meetings of the membership, board of directors, credit committee, and supervisory committee.

(b) One copy of each NCUA 5300 financial report or its equivalent.

(c) One copy of each supervisory committee comprehensive annual audit report and attachments.

(d) Supervisory committee records of account verification.

(e) Applications for membership and joint share account agreements.

(f) Journal and cash record.

(g) General ledger.

(h) Copies of the periodic statements of members, or the individual share and loan ledger. (A complete record of the account should be kept permanently.)

(i) Bank reconcilements.

(j) Listing of records destroyed.

F. What Records Should a Credit Union Designate for Periodic Destruction?

Any record not described above is appropriate for periodic destruction unless it must be retained to comply with the requirements of consumer protection regulations. Periodic destruction should be scheduled so that the most recent of the following records are available for the annual supervisory committee audit and the NCUA examination. Records that may be periodically destroyed include:

(a) Applications of paid off loans.

(b) Paid notes.

(c) Various consumer disclosure forms, unless retention is required by law.

(d) Cash received vouchers.

(e) Journal vouchers.

(f) Canceled checks.

(g) Bank statements.

(h) Outdated manuals, canceled instructions, and nonpayment correspondence from the NCUA and other governmental agencies.

Part 760

Loans in Areas Having Special Flood Hazards

§ 760.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued pursuant to 12 U.S.C. 1757, 1789 and 42 U.S.C. 4012a, 4104a, 4104b, 4106, 4128.

(b) *Purpose.* The purpose of this part is to implement the requirements of the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(c) *Scope.* This part, except for §§ 760.6 and 760.8, applies to loans secured by buildings or mobile homes located or to be located in areas determined by the Director of the Federal Emergency Management Agency to have special flood hazards. Sections 760.6 and 760.8 apply to loans secured by buildings or mobile homes, regardless of location.

§ 760.2 Definitions.

(a) *Act* means the National Flood Insurance Act of 1968, as amended (42 U.S.C. 4001–4129).

(b) *Credit union* means a Federal or State-chartered credit union that is insured by the National Credit Union Share Insurance Fund.

(c) *Building* means a walled and roofed structure, other than a gas or liquid storage tank, that is principally above ground and affixed to a permanent site, and a walled and roofed structure while in the course of construction, alteration, or repair.

(d) *Community* means a State or a political subdivision of a State that has zoning and building code jurisdiction over a particular area having special flood hazards.

(e) *Designated loan* means a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in which flood insurance is available under the Act.

(f) *Director of FEMA* means the Director of the Federal Emergency Management Agency.

(g) *Mobile home* means a structure, transportable in one or more sections, that is built on a permanent chassis and designed for use with or without a permanent foundation when attached to the required utilities. The term *mobile home* does not include a recreational vehicle. For purposes of this part, the term *mobile home* means a mobile home on a permanent foundation. The term *mobile home* means a manufactured home as that term is used in the NFIP.

(h) *NFIP* means the National Flood Insurance Program authorized under the Act.

(i) *Residential improved real estate* means real estate upon which a home or other residential building is located or to be located.

(j) *Servicer* means the person responsible for:

(1) Receiving any scheduled, periodic payments from a borrower under the terms of a loan, including amounts for taxes, insurance premiums, and other charges with respect to the property securing the loan; and

(2) Making payments of principal and interest and any other payments from the amounts received from the borrower as may be required under the terms of the loan.

(k) *Special flood hazard area* means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Director of FEMA.

(l) *Table funding* means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.

§ 760.3 Requirement to purchase flood insurance where available.

(a) *In general.* A credit union shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located.

(b) *Table funded loan.* A credit union that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purposes of this part.

§ 760.4 Exemptions.

The flood insurance requirement prescribed by § 760.3 does not apply with respect to:

(a) Any State-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA, who publishes and periodically revises the list of States falling within this exemption; or

(b) Property securing any loan with an original principal balance of $5,000 or less and a repayment term of one year or less.

§ 760.5 Escrow requirement.

If a credit union requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by *residential* improved real estate or a mobile home that is made, increased, extended, or renewed on or after November 1, 1996, the credit union shall also require the escrow of all premiums and fees for any flood insurance required under § 760.3. The credit union, or a servicer acting on behalf of the credit union, shall deposit the flood insurance premiums on behalf of the borrower in an escrow account. This escrow account will be subject to escrow requirements adopted pursuant to section 10 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2609) (RESPA), which generally limits the amount that may be maintained in escrow accounts for certain types of loans and requires escrow account statements for those accounts, only if the loan is otherwise subject to RESPA. Following receipt of a notice from the Director of FEMA or other provider of flood insurance that premiums are due, the credit union, or a servicer acting on behalf of the credit union, shall pay the amount owed to the insurance provider from the escrow account by the date when such premiums are due.

§ 760.6 Required use of standard flood hazard determination form.

(a) Use of form. A credit union shall use the standard flood hazard determination form developed by the Director when determining whether the building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area in which flood insurance is available under the Act. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner. A credit union may obtain the standard flood hazard determination form from FEMA, P.O. Box 2012, Jessup, MD 20794–2012.

(b) *Retention of form.* A credit union shall retain a copy of the completed standard flood hazard determination form, in either hard copy or electronic form, for the period of time the credit union owns the loan.

§ 760.7 Forced placement of flood insurance.

If a credit union, or a servicer acting on behalf of the credit union, determines, at any time during the term of a designated loan that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered by flood insurance in an amount less than the amount required under § 760.3, then the credit union or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required under § 760.3, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the credit union or its servicer shall purchase insurance on the borrower's behalf. The credit union or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance.

§ 760.8 Determination fees.

(a) *General.* Notwithstanding any Federal or State law other than the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129), any credit union, or a servicer acting on behalf of the credit union, may charge a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a special flood hazard area. A determination fee may also include, but is not limited to, a fee for life-of-loan monitoring.

(b) *Borrower fee.* The determination fee authorized by paragraph (a) of this section may be charged to the borrower if the determination:

(1) Is made in connection with a making, increasing, extending, or renewing of the loan that is initiated by the borrower;

(2) Reflects the Director of FEMA's revision or updating of floodplain areas or flood-risk zones;

(3) Reflects the Director of FEMA's publication of a notice or compendium that:

(i) Affects the area in which the building or mobile home securing the loan is located; or

(ii) By determination of the Director of FEMA, may reasonably require a determination whether the building or mobile home securing the loan is located in a special flood hazard area; or

(4) Results in the purchase of flood insurance coverage by the credit union or its servicer on behalf of the borrower under § 760.7.

(c) *Purchaser or transferee fee.* The determination fee authorized by paragraph (a) of this section may be charged to the purchaser or transferee of a loan in the case of the sale or transfer of the loan.

§ 760.9 Notice of special flood hazards and availability of Federal disaster relief assistance.

(a) *Notice requirement.* When a credit union makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area, the credit union shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

(b) *Contents of notice.* The written notice must include the following information:

(1) A warning, in a form approved by the Director of FEMA, that the building or the mobile home is or will be located in a special flood hazard area;

(2) A description of the flood insurance purchase requirements set forth in section 102(b) of the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4012a(b));

(3) A statement, where applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers; and

(4) A statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally-declared disaster.

(c) *Timing of notice.* The credit union shall provide the notice required by paragraph (a) of this section to the borrower within a reasonable time before the completion of the transaction and to the servicer as promptly as practicable after the credit union provides notice to the borrower and in any event no later than the time the credit union provides other similar notices to the servicer concerning hazard insurance and taxes. Notice to the servicer may be made electronically or may take the form of a copy of the notice to the borrower.

(d) *Record of receipt.* The credit union shall retain a record of the receipt of the notices by the borrower and the servicer for the period of time the credit union owns the loan.

(e) *Alternate method of notice.* Instead of providing the notice to the borrower required by paragraph (a) of this section, a credit union may obtain satisfactory written assurance from a seller or lessor that, within a reasonable time before the completion of the sale or lease transaction, the seller or lessor has provided such notice to the purchaser or lessee. The credit union shall retain a record of the written assurance from the seller or lessor for the period of time the credit union owns the loan.

(f) *Use of prescribed form of notice.* A credit union will be considered to be in compliance with the requirement for notice to the borrower of this section providing written notice to the borrower containing the language presented in the appendix to this part within a reasonable time before the completion of the transaction. The notice presented in the appendix to this part satisfies the borrower notice requirements of the Act.

§ 760.10 Notice of servicer's identity.

(a) *Notice requirement.* When a credit union makes, increases, extends, renews, sells, or transfers a loan secured by a building or mobile home located or to be located in a special flood hazard area, the credit union shall notify the Director of FEMA (or the Director's designee) in writing of the identity of the servicer of the loan. The Director of FEMA has designated the insurance provider to receive the credit union's notice of the servicer's identity. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee.

(b) *Transfer of servicing rights.* The credit union shall notify the Director of FEMA (or the Director's designee) of any change in the servicer of a loan described in paragraph (a) of this section within 60 days after the effective date of the change. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee. Upon any change in the servicing of a loan described in paragraph (a) of this section, the duty to provide notice under this paragraph (b) shall transfer to the transferee servicer.

Appendix to Part 760—Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's *Flood Insurance Rate Map* or the *Flood Hazard Boundary Map* for the following community: _____. This area has at least a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

_____ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance also may be available from private insurers that do not participate in the NFIP.
- At a minimum, flood insurance purchased must cover *the lesser of*:

(1) the outstanding principal balance of the loan; *or*

(2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

_____ Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally-declared flood disaster.

Part 790

Description of NCUA; Requests for Agency Action.

§ 790.1 Scope.

This Part contains a description of NCUA's organization and the procedures for public requests for action by the Board. Part 790 pertains to the practices of the National Credit Union Administration (NCUA) only and does not apply to credit union operations.

§ 790.2 Central and Regional Office Organization.

(a) *General organization.* NCUA is composed of the Board with a Central Office in Alexandria, Virginia, six Regional Offices, the Asset Management and Assistance Center, the Community Development Revolving Loan Program, and the NCUA Central Liquidity Facility (CLF).

(b) *Central Office.* The Central Office address is NCUA, 1775 Duke St., Alexandria, Virginia 22314–3428.

(1) *The NCUA Board.* NCUA is managed by its Board. The Board consists of three members appointed by the President, with the advice and consent of the Senate, for six-year terms. One Board member is designated by the President to be Chairman of the Board. A second member is designated by the Board to be Vice-Chairman. The Board is also responsible for management of the National Credit Union Share Insurance Fund (NCUSIF) and serves as the Board of Directors of the CLF. The Chairman shall be the spokesman for the Board and shall represent the Board and the NCUA in its official relations with other branches of the government.

(2) *Secretary of the Board.* The Secretary of the Board is responsible for the secretarial functions of the Board. The Secretary's responsibilities include preparing agendas for meetings of the Board, preparing and maintaining the minutes for all official actions taken by the Board, and executing and maintaining all documents adopted by the Board or under its direction. The Secretary also serves as the Secretary of the CLF.

(3) *Asset Management and Assistance Center.* The President of the Asset Management and Assistance Center (AMAC) is responsible for monitoring, evaluating, disposing, and/or managing major assets acquired by NCUA; responsible for managing involuntary liquidations for all federally insured credit unions placed into involuntary liquidation including the orderly processing of payments of share insurance, sale and/or collection of loan portfolios, liquidation of other assets and achieving other recoveries, payments to creditors, and distributions to any uninsured shareholders. The President, AMAC, serves as a primary consultant with the regional offices on asset sales or purchases to restructure problem case credit unions, as technical expert to evaluate specific areas of credit union operations, and as instructor in training classes; responsible to prepare and negotiate bond claims; responsible to manage or assist in the management of conservatorships. The address of AMAC is 4807 Spicewood Springs Road, Suite 5100, Austin, Texas 78759–8490.

(4) *Office of Chief Financial Officer.* NCUA's chief financial officer is in charge of budgetary, accounting and financial matters for the NCUA, including responsibility for submitting annual budget and staffing requests for approval by the Board and, as required, by the Office of Management and Budget; for managing NCUA's budgetary resources; for managing the operations of the National Credit Union Share Insurance Fund (NCUSIF) to include accounting, financial reporting and the collection and payment of capitalization deposits, insurance premiums and insurance dividends; for collecting annual operating fees from federal credit unions, for maintaining NCUA's accounting system and accounting records; for processing payroll, travel, and accounts payable disbursements; and for preparing internal and external financial reports. The Director is also responsible for providing NCUA's executive offices and Regional Directors with administrative services, including: agency security; contracting and procurement; management of equipment and supplies; acquisition; printing; and warehousing and distribution.

(5) *Office of Examination and Insurance.*

(i) The Director of the Office of Examination and Insurance: Formulates standards and procedures for examination and supervision of the community of federally insured credit unions, and reports to the Board on the performance of the examination program; manages the risk to the NCUSIF, to include overseeing the NCUSIF Investment Committee, monitoring the adequacy of NCUSIF reserves, analyzing the reasons for NCUSIF losses, formulating policies and procedures regarding the supervision of financially troubled credit unions, and evaluating certain requests for special assistance pursuant to Section 208 of the Federal Credit Union Act and for certain proposed administrative actions regarding federally-insured credit unions; serves as the Board expert on accounting principles and standards and on auditing standards; represents NCUA at meetings with the American Institute of Certified Public Accountants (AICPA), Federal Financial Institutions Examination Council (FFIEC) and General Accounting Office (GAO); and collects data and provides statistical reports. The Director is also responsible for developing and conducting research in support of NCUA programs, and for preparing reports on research activities for the information and use of agency staff, credit union officials, state credit union supervisory authorities, and other governmental and private groups.

(ii) *NCUA Central Liquidity Facility (CLF).* The CLF was created to improve general financial stability by providing funds to meet the liquidity needs of credit unions. It is a mixed-ownership government corporation under the Government Corporation Control Act (31 U.S.C. 9101 *et seq.*). The CLF is managed by the President, under the general supervision of the NCUA Board which serves as the CLF Board of Directors. The Chairman of the NCUA Board serves as the Chairman of the CLF Board of Directors. The Secretary of the NCUA Board serves as the Secretary of the CLF Board of Directors. The NCUA Board shall appoint the CLF President and Vice President.

(6) *Office of the Executive Director.* The Executive Director reports to the entire NCUA Board. The Executive Director translates NCUA Board policy decisions into workable programs, delegates responsibility for these programs to appropriate staff members, and coordinates the activities of the senior executive staff, which includes: the General Counsel; the Regional Directors; and the Office Directors for Administration, Chief Financial Officer, Examination and Insurance, Human Resources, Chief Information Officer, and Public and Congressional Affairs. Because of the nature of the attorney/client relationship between the Board and General Counsel, the General Counsel may be directed by the Board not to disclose discussions and/or assignments with anyone, including the Executive Director. The Executive Director is otherwise to be privy to all matters within senior executive staff's responsibility.

(7) *Office of General Counsel.* The General Counsel reports to the entire NCUA Board. The General Counsel has overall responsibility for all legal matters affecting NCUA and for liaison with the Department of Justice. The General Counsel represents NCUA in all litigation and administrative hearings when such direct representation is permitted by law and, in other instances, assists the attorneys responsible for the conduct of such litigation. The General Counsel also provides NCUA with legal advice and opinions on all matters of law, and the public with interpretations of the Federal Credit Union Act, the NCUA Rules and Regulations, and other NCUA Board directives. The General Counsel has responsibility for the drafting, reviewing, and publication of all items which appear in the **Federal Register**, including rules, regulations, and notices required by law. The office has responsibility for processing Freedom of Information requests and appeals and carrying out the Board's responsibilities under the Privacy Act.

(8) *The Office of Human Resources.* The Office of Human Resources provides a comprehensive program for the management of NCUA's human resources. This is done in support of NCUA's goal to recruit, develop, and retain a quality and representative workforce. The Director is responsible for managing NCUA's compensation program, for facilitating good organization design, for staffing positions through recruitment and merit promotion programs, and for maintaining an automated personnel records system. The Director is also responsible for the Board's performance management, incentive awards, employee assistance, and benefit programs. These programs are geared to foster healthy employee/management relations and to provide employees with good working conditions. The Director is also responsible for providing a comprehensive program for the training and development of

NCUA's staff, including developing policy consistent with the Government Employees Training Act; providing training opportunities equitably so that all employees have the skills necessary to help meet the agency's mission; evaluating the agency's training and development efforts; and ensuring that the agencies training monies are spent in a cost efficient manner and in accordance with the law.

(9) *Office of Chief Information Officer.* The Chief Information Officer has responsibility for the management and administration of NCUA's information resources. This includes the development, maintenance, operation, and support of information systems which directly support the Agency's mission, maintaining and operating the Agency's information processing infrastructure, responding to requests for releaseable Agency information, and insuring all related material security and integrity risks are recognized and controlled as much as possible. The Chief Information Officer is also responsible for carrying out the Board's responsibilities under the Paperwork Reduction Act and in directing NCUA responses to reporting requirements.

(10) *Office of the Inspector General.* The Inspector General reports directly to the Board and provides semiannual reports regarding audit and investigation activities to the Board and the Congress. The Inspector General is responsible for: (a) conducting independent audits and investigations of all NCUA programs and functions to promote efficiency; (b) reviewing policies and procedures to evaluate controls to prevent fraud, waste, and abuse; and (c) reviewing existing and proposed legislation and regulations to evaluate their impact on the economic and efficient administration of the Agency.

(11) *Office of Public and Congressional Affairs.* The Director of the Office of Public and Congressional Affairs is responsible for maintaining NCUA's relationship with the public and the media; for liaison with the U.S. Congress, and with other Executive Branch agencies concerning legislative matters; and for the analysis and development of legislative proposals and public affairs programs. The Director is also responsible for providing NCUA's executive offices and Regional Directors with graphics.

(12) *Office of Credit Union Development.* This Office is responsible for coordinating NCUA policy as it relates to community development credit unions, including those credit unions designated as "low-income." The Office administers the Community Development Revolving Loan Program for Credit Unions (Program). This Program was funded from a congressional appropriation and serves as a loan and technical assistance vehicle for low-income credit unions. The Office Director serves as Program Chairman and authorizes loans and technical assistance to participating credit unions. The Program is governed by part 705 of subchapter A of this chapter.

(13) *Office of Strategic Program Support and Planning.* This office is responsible for providing interest rate risk assessment, investment expertise and advice to the Board and agency staff and conducting research and development to assess risk areas of emerging products, delivery systems, infrastructure issues, and investments. The office provides leadership, vision and focus on the internal and external environment related to the development of the agency's long range planning and implementation of the Government Performance Act of 1993. The office provides a macro view of the industry in a way that can be integrated into the day-to-day program functions. A working relationship is maintained with the financial marketplace to develop resources available to the NCUA and keep abreast of product initiatives. The NCUA Investment Hotline housed in this office is a toll-free number that is available to examiners, credit unions and financial product vendors to ask investment related questions. The Hotline provides NCUA an opportunity to be aware of current investment issues as they arise in credit unions and has permitted NCUA to become proactive, rather than reactive, to such issues. In addition, investment officers advise agency management on the purchase of authorized investments for the NCUSIF and the CLF.

(14) *Office of Corporate Credit Unions.* The Director, Office of Corporate Credit Unions, manages NCUA's corporate credit union program in accordance with established policies and the corporate regulation. The Director's duties include directing chartering, examination and supervision programs to promote and assure safety and soundness; managing NCUA's corporate resources to meet program objectives in the most economical and practical manner; and maintaining good public relations with public, private and governmental organizations, corporate credit union officials, credit union

organizations, and other groups which have an interest in corporate credit union matters.

(c) *Regional Offices.*

(1) NCUA's programs are conducted through six Regional Offices:

(2) A Regional Director is in charge of each Regional Office. The Regional Director manages NCUA's programs in the Region assigned in accordance with established policies. This person's duties include: directing chartering, insurance, examination, and supervision programs to promote and assure safety and soundness; managing regional resources to meet program objectives in the most economical and practical manner; and maintaining good public relations with public, private, and governmental organizations, Federal credit union officials, credit union organizations, and other groups which have an interest in credit union matters in the assigned Region. The Director maintains liaison and cooperation with other regional offices of Federal departments and agencies, state agencies, city and county officials, and other governmental units that affect credit unions. The Regional Director is aided by an Associate Regional Director for Operations and Associate Regional Director for Programs. Staff working in the Regional Office report to the Associate Regional Director for Operations. Each region is divided into examiner districts, each assigned to a Supervisory Credit Union Examiner; groups of examiners are directed by a Supervisory Credit Union Examiner, each of whom in turn reports directly to the Associate Regional Director for Programs.

Region No.	Area Within Region	Office Address
I	Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont	9 Washington Square Washington Avenue Extension Albany, NY 12205
II	Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia, West Virginia	1775 Duke Street Suite 4206 Alexandria, VA 22314–3437
III	Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, Virgin Islands	7000 Central Parkway Suite 1600 Atlanta, GA 30328
IV	Illinois, Indiana, Michigan, Missouri, Ohio, Wisconsin	4225 Naperville Road Suite 125 Lisle, IL 60532
V	Arizona, Colorado, Iowa, Kansas, Minnesota, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Utah, Wyoming	4807 Spicewood Springs Road Suite 5200 Austin, TX 78759
VI	Alaska, American Samoa, California, Guam, Hawaii, Idaho, Montana, Nevada, Oregon, Washington	2300 Clayton Road Suite 1350 Concord, CA 94520

§ 790.3 Requests for Action.

Except as otherwise provided by NCUA regulation, all applications, requests, and submittals for action by the NCUA shall be in writing and addressed to the appropriate office described in § 790.2. This will usually be one of the Regional Offices. In instances where the appropriate office cannot be determined, requests should be sent to the Office of Public and Congressional Affairs.

Part 791

Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observation of NCUA Board Meetings

Subpart A—Rules of NCUA Board Procedure

§ 791.1 Scope.

The rules contained in this Subpart are the rules of procedure governing how the Board conducts its business. These rules concern the Board's exercise of its authority to act on behalf of NCUA; the conduct, scheduling and subject matter of Board meetings; and the recording of Board action.

§ 791.2 Number of Votes Required for Board Action.

The agreement of at least two of the three Board members is required for any action by the Board.

§ 791.3 Voting by Proxy.

Proxy voting shall not be allowed for any action by the Board.

§ 791.4 Methods of Acting.

(a) *Board Meeting.*

(1) *Applicability of the Sunshine Act.* The Government in the Sunshine Act (5 U.S.C. 552b, "Sunshine Act") requires that joint deliberations of the Board be held in accordance with its open meetings provisions (5 U.S.C. 552b(b)–(f)). (Subpart C of this Part contains NCUA's regulations implementing the Sunshine Act.)

(2) *Presiding officer.* The Chairman is the presiding officer, and in the Chairman's absence, the designated Vice Chairman shall preside. The presiding officer shall make procedural rulings. Any Board member may appeal a ruling made by the presiding officer. The appeal of a procedural ruling by the presiding officer shall be immediately considered by the Board, and a majority decision by the Board shall decide the procedural ruling.

(b) *Notation voting.* Notation voting is the circulation of written memoranda and voting sheets to the office of each Board member simultaneously and the tabulation of responses.

(1) *Matters that may be Decided by Notation Voting.* Notation voting may be used only for routine matters.

(2) *Notation Vote Sheets.* Notation vote sheets will be used to record the vote tally on a notation vote. The Secretary of the Board has administrative responsibility over notation voting, including the authority to establish deadlines for voting, receive notation vote sheets, count votes, and determine whether further action is required.

(3) *Veto of notation voting.* In view of public policy for openness reflected in the Sunshine Act, each Board member is authorized to veto the use of notation voting for the consideration of any particular matter, and thus require that the matter be placed on the agenda of the next regularly scheduled Board meeting that is held at least ten days after the date of the veto.

(4) *Disclosure of Result.* A record is to be maintained of Board transactions by use of the notation voting procedure. Public disclosure of this record is determined by the provisions of the Freedom of Information Act (5 U.S.C. § 552).

§ 791.5 Scheduling of Board Meetings.

(a) *Meeting Calls.*

(1) *Regular Meetings.* The Board will hold regular meetings each month unless there is no business or a quorum is not available. The Secretary of the Board will coordinate the dates for meetings.

(2) *Special meetings.* The Chairman shall call special meetings either on the Chairman's own initiative or within fourteen days of a request from two Board members that is accompanied by an NCUA B–1 form and a Board Action Memorandum that states the specific issue(s) or action(s) to be considered by the Board.

(b) *Notice of Meetings.*

(1) *Notifying the Public.* The Sunshine Act and Subpart C set forth the procedures for notifying the public of Board meetings.

(2) *Notifying Board Members.*

(i) *Special Meetings.* Except in cases of emergency as determined by a majority of the Board, each Board member is entitled to receive notice of any special meeting at least twenty-

four hours in advance of such meeting. The notice shall set forth the place, day, hour, and nature of business to be transacted at the meeting. In cases of emergency, a record of the vote, including a statement explaining the decision that an emergency exists, will be maintained.

(ii) *Regular Meetings.* Each Board member entitled to receive notice of the agenda and/or notice of any changes in the subject matter of such meetings concurrent with the public release of such notices under the Sunshine Act. Each Board member shall be entitled to at least twenty-four hours advance notice of the consideration of a particular subject matter, except in cases of emergency as determined by a majority of the Board. In cases of emergency, a record of the vote, including a statement explaining the decision that an emergency exists, will be maintained.

§ 791.6 Subject Matter of a Meeting.

(a) *Agenda.* The Chairman is responsible for the final order of each meeting agenda. Items shall be placed on the agenda by determination of the Chairman or, at the request of any Board Member, an item will be placed on the agenda of the next regularly scheduled meeting provided that the request is submitted at least ten days in advance of the next regularly scheduled meeting and is accompanied by an NCUA B–1 form and a Board Action Memorandum that states the specific issue(s) or action(s) to be considered by the Board.

(b) *Submission of Recommended Agenda Items.* Recommended agenda items may be submitted to the Secretary of the Board by Board members, the Executive Staff (which includes all Office Directors and President of the Central Liquidity Facility), and Regional Directors.

Subpart B—Promulgation of NCUA Rules and Regulations

§ 791.7 Scope.

The rules contained in this Subpart B pertain to the promulgation of NCUA Rules and Regulations.

§ 791.8 Promulgation of NCUA rules and regulations.

(a) NCUA's procedures for developing regulations are governed by the Administrative Procedure Act (5 U.S.C. 551 *et seq.*), the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), and NCUA's policies for the promulgation of rules and regulations as set forth in its Interpretive Ruling and Policy Statement 87–2 as amended by Interpretive Ruling and Policy Statement 03–2.

(b) *Proposed Rulemaking.* Notices of proposed rulemaking are published in the Federal Register except as specified in paragraph (d) or as otherwise provided by law. A notice of proposed rulemaking may also be identified as a "request for comments" or as a "proposed rule." The notice will include:

(1) a statement of the nature of the rulemaking proceedings;

(2) reference to the authority under which the rule is proposed;

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved; and

(4) a statement of the effect of the proposed rule on state-chartered federally-insured credit unions.

(c) *Public Participation.* After publication of notice of proposed rulemaking, interested persons will be afforded the opportunity to participate in the making of the rule through the submission of written data, views, or arguments, delivered within the time prescribed in the notice of proposed rulemaking, to the Secretary, NCUA Board, 1775 Duke Street, Alexandria, VA 22314–3428. Interested persons may also petition the Board for the issuance, amendment, or repeal of any rule by mailing such petition to the Secretary of the Board at the address given in this section.

(d) *Exceptions to Notice.* The following are not subject to the notice requirement contained in paragraph (b) of this section:

(1) matters relating to agency management or personnel or to public property, loans, grants, benefits, or contracts;

(2) when persons subject to the proposed rule are named and either personally served or otherwise have actual notice thereof in accordance with law;

(3) interpretive rules, general statements of policy, or rules of agency organization, procedure or practice, unless notice or hearing is required by statute; and

(4) if the Board, for good cause, finds (and incorporates the finding and a brief statement therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest, unless notice or hearing is required by statute.

(e) *Effective Dates.* No substantive rule issued by NCUA shall be effective less than 30 days after its publication in the Federal Register, except that this requirement may not apply to:

(1) rules which grant or recognize an exemption or relieve a restriction;

(2) interpretive rules and statements of policy; or

(3) any substantive rule which the Board makes effective at an earlier date upon good cause found and published with such rule.

Subpart C—Public Observation of NCUA Board Meetings Under the Sunshine Act

§ 791.9 Scope.

This subpart contains regulations implementing subsections (b) through (f) of the "Government in the Sunshine Act" [5 U.S.C. § 552b]. The primary purpose of these regulations is to provide the public with the fullest access authorized by law to the deliberations and decisions of the Board, while protecting the rights of individuals and preserving the ability of the agency to carry out its responsibilities.

§ 791.10 Definitions.

For the purpose of this subpart:

(a) "agency" means the National Credit Union Administration;

(b) "Board" means the National Credit Union Administration Board, whose members were appointed by the President with the advice and consent of the Senate;

(c) "subdivision of the Board" means a group composed of two Board members authorized by the Board to act on behalf of the agency;

(d) "meeting" means any deliberations by two or more members of the Board or any subdivision of the Board that determine or result in the joint conduct or disposition of official agency business with the exception of:

(1) deliberations to determine whether a meeting or a portion thereof will be open or closed to public observation and whether information regarding closed meetings will be withheld from public disclosure;

(2) deliberations to determine whether or when to schedule a meeting; and

(3) infrequent dispositions of official agency business by sequential circulation of written recommendations to individual Board members ("notation voting procedure"), provided the votes of each Board member and the action taken are recorded for each matter and are publicly available, unless exempted from disclosure pursuant to 5 U.S.C. § 552 (the Freedom of Information Act);

(e) "public observation" means that a member or group of the public may listen to and observe any open meeting and may record in an unobtrusive manner any portion of that meeting by use of a camera or any other electronic device, but shall not participate in any meeting unless authorized by the Board;

(f) "public announcement" or "publicly announce" means reasonable efforts under the particular circumstances to fully inform the public, especially those individuals who have expressed interest in the subject matters to be discussed or the decisions of the agency;

(g) "Sunshine Act" means the open meeting provisions of the "Government in the Sunshine Act" (5 U.S.C. § 552b).

§ 791.11 Open Meetings.

Except as provided in Section 791.12(a), any portion of any meeting of the Board shall be open to public observation. The Board, and any subdivision of the Board, shall jointly conduct official agency business only in accordance with this subpart.

§ 791.12 Exemptions.

(a) Under the procedures specified in Section 791.14, the Board may close a meeting or any portion of a meeting from public observation or may withhold information pertaining to such meetings provided the Board has properly determined that the public interest does not require otherwise and that the meeting (or any portion thereof) or the disclosure of meeting information is likely to:

(1) disclose matters that are (i) specifically authorized under criteria established by an Executive Order to be kept secret in the interests of national defense or foreign policy, and (ii) in fact properly classified pursuant to such Executive Order;

(2) relate solely to internal personnel rules and practices;

(3) disclose matters specifically exempted from disclosure by statute (other than Section 552 of Title 5 of the United States Code, the Freedom of Information Act), provided that such statute (i) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (ii) establishes par-

ticular criteria for withholding or refers to particular types of matters to be withheld;

(4) disclose trade secrets and commercial or financial information obtained from a person and privileged or confidential;

(5) involve accusing any person of a crime, or formally censuring any person;

(6) disclose information of a personal nature where disclosure would constitute a clearly unwarranted invasion of personal privacy;

(7) disclose investigatory records compiled for enforcement purposes, or information which if written would be contained in such records, but only to the extent that the production of such records or information would (i) interfere with enforcement proceedings, (ii) deprive a person of a right to a fair trial or an impartial adjudication, (iii) constitute an unwarranted invasion of personal privacy, (iv) disclose the identity of a confidential source and, in the case of a record compiled by a criminal law enforcement authority in the course of a criminal investigation, or by a Federal agency conducting a lawful national security intelligence investigation, confidential information furnished only by the confidential source, (v) disclose investigation techniques and procedures, or (vi) endanger the life or physical safety of law enforcement personnel;

(8) disclose information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of Federal agencies responsible for the regulation or supervision of financial institutions;

(9) disclose information the premature disclosure of which would be likely to (A)(i) lead to significant speculation in currencies, securities, or commodities, or (ii) significantly endanger the stability of any financial institution, or (B) be likely to significantly frustrate implementation of a proposed action, except that this subparagraph shall not apply in any instance where the Board has already disclosed to the public the content or nature of its proposed action, or where the Board is required by law to make such disclosure on its own initiative prior to taking final action on such proposal; or

(10) specifically concern the issuance of a subpoena, participation in a civil action or proceeding, an action in a foreign court or international tribunal, or an arbitration, or the initiation, conduct or disposition of a particular case of formal agency adjudication pursuant to the procedures in Section 554 of Title 5 of the United States Code or otherwise involving a determination on the record after opportunity for a hearing.

(b) Prior to closing a meeting whose discussions are likely to fall within the exemptions stated in paragraph (a) of this Section, the Board will balance the public interest in observing the deliberations of an exemptible matter and the agency need for confidentiality of the exemptible matter. In weighing these interests, the Board is assisted by the General Counsel as provided in Section 791.16, by expressions of the public interest set forth in requests for open meetings as provided by Section 791.15(b), and by the brief staff analysis of public interest which will accompany each staff recommendation that an agenda item be considered in a closed meeting.

§ 791.13 Public Announcement of Meetings.

(a) Except as otherwise provided in this Section, the Board shall, for each meeting, make a public announcement, at least one week in advance of the meeting, of the time, place and subject matter of the meeting, whether it will be open or closed to public observation, and the name and telephone number of the Secretary of the Board or the person designated by the Board to respond to requests for information about the meeting.

(b) Advance notice is required unless a majority of the members of the Board determine by a recorded vote that agency business requires that a meeting be called at an earlier date, in which case, the information to be announced in paragraph (a) of this Section shall be publicly announced at the earliest practicable time.

(c) A change, including a postponement or a cancellation, in the time or place of a meeting after a published announcement may be made only if announced at the earliest practicable time.

(d) A change in or deletion of the subject matter of a meeting or any portion of a meeting or a redetermination to open or close a meeting or any portion of a meeting after a published announcement may be made only if (1) a majority of the Board determines by recorded vote that agency business so requires and that no earlier announcement of the change was possible and (2) public announcement of the change and of the vote of each member on such change shall be made at the earliest practicable time.

(e) Each meeting announcement or amendment thereof shall be posted on the Public Notice Bulletin Board in the reception area of the agency

headquarters and may be made available by other means deemed desirable by the Board. Immediately following each public announcement required by this Section, the stated information shall be submitted to the Federal Register for publication.

(f) No announcement shall contain information which is determined to be exempt from disclosure under Section 791.12(a).

(g) The agency shall maintain a mailing list of names and addresses of all persons who wish to receive copies of agency announcements of meetings open to public observation and amendments to such announcements. Requests to be placed on the mailing list should be made by telephoning or by writing to the Secretary of the Board.

§ 791.14 Regular Procedure for Closing Meeting Discussions or Limiting the Disclosure of Information.

(a) A decision to close any portion of a meeting and to withhold information about any portion of a meeting closed pursuant to Section 791.12(a) will be taken only when a majority of the entire Board votes to take such action. In deciding whether to close a meeting or any portion of a meeting or to withhold information, the Board shall independently consider whether the public interest requires an open meeting. A separate vote of the Board will be taken and recorded for each portion of a meeting to be closed to public observation pursuant to Section 791.12(a) or to withhold information from the public pursuant to Section 791.12(a). A single vote may be taken and recorded with respect to a series of meetings, or any portions of meetings which are proposed to be closed to the public, or with respect to any information concerning the series of meetings, so long as each meeting in the series involves the same particular matters and is scheduled to be held no more than thirty days after the initial meeting in such series. No proxies shall be allowed.

(b) Any person whose interests may be directly affected by any portion of a meeting for any of the reasons stated in subparagraphs (5), (6) or (7) of Section 791.12(a) may request that the Board close such portion of the meeting. After receiving notice of a person's desire for any specified portion of a meeting to be closed, the Board, upon a request by one member, will decide by recorded vote whether to close the relevant portion or portions of the meeting. This procedure applies to requests received either prior or subsequent to the announcement of a decision to hold an open meeting.

(c) Within one day after any vote is taken pursuant to paragraphs (a) or (b) of this Section, the Board shall make publicly available a written copy of the vote taken indicating the vote of each Board member. Except to the extent that such information is withheld and exempt from disclosure, for each meeting or any portion of a meeting closed to the public, the Board shall make publicly available within one day after the required vote, a written explanation of its action, together with a list of all persons expected to attend the closed meeting and their affiliation. The list of persons to attend need not include the names of individual staff, but shall state the offices of the agency expected to participate in the meeting discussions.

§ 791.15 Requests for Open Meeting.

(a) Following any announcement that the Board intends to close a meeting or any portion of any meeting, any person may make a written request to the Secretary of the Board that the meeting or a portion of the meeting be open. The request shall be circulated to the members of the Board, and the Board, upon the request of one member, shall reconsider its action under Section 791.14 before the meeting or before discussion of the matter at the meeting. If the Board decides to open a portion of a meeting proposed to be closed, the Board shall publicly announce its decision in accordance with Section 791.13(e). If no request is received from a Board member to reconsider the decision to close a meeting or portion thereof prior to the meeting discussion, the Chairman of the Board shall certify that the Board did not receive a request to reconsider its decision to close the discussion of the matter.

(b) The request to open a portion of a meeting shall be submitted to the Secretary of the Board in advance of the meeting in question. The request shall set forth the requestor's interest in the matter to be discussed and the reasons why the requestor believes that the public interest requires that the meeting or portions thereof be open to public observation.

(c) The submission of a request to open a portion of a meeting shall not act to stay the effectiveness of Board action or to postpone or delay the meeting unless the Board decides otherwise.

(d) The Secretary of the Board shall advise the requestor of the Board's consideration of the re-

quest to open a portion of the meeting as soon as practicable.

§ 791.16 General Counsel Certification.

For each meeting or any portion of a meeting closed to public observation under Section 791.14, the General Counsel shall publicly certify, whether in his or her opinion, the meeting or portion thereof may be closed to public observation and shall state each relevant exemption provision of law. A copy of the certification, together with a statement from the presiding officer of the meeting setting forth the time and place of the meeting and the persons present, shall be retained as a part of the permanent meeting records. As part of the certification, the General Counsel shall recommend to the Board whether the public interest requires that the meeting or portions thereof proposed to be closed to public observation be held in the open.

§ 791.17 Maintenance of Meeting Records.

(a) Except in those circumstances which are beyond the control of the agency, the Board shall maintain a complete transcript or electronic recording adequate to record fully the proceedings of each meeting, or any portion thereof, closed to public observation. However, for meetings closed under subparagraphs (8), (9)(A) or (10) of Section 791.12(a), the Board shall maintain either a transcript, a recording or a set of minutes. The Board shall maintain a complete electronic recording for each open meeting or any portion thereof. All records shall clearly identify each speaker.

(b) A set of minutes shall fully and clearly describe all matters discussed and shall provide a full and accurate summary of any actions taken, and the reasons for taking such action. Minutes shall also include a description of each of the views expressed by each person in attendance on any item and the record of any roll call vote, reflecting the vote of each member. All documents considered in connection with any action shall be identified in the minutes.

(c) The agency shall maintain a complete verbatim copy of the transcript, a complete copy of the minutes or a complete electronic recording of each meeting, or any portion of a meeting, closed to public observation, for at least two years after such meeting or for one year after the conclusion of any agency proceeding with respect to which the meeting or any portion was held, whichever occurs later. The agency shall maintain a complete electronic recording of each open meeting for at least three months after the meeting date. A complete set of minutes shall be maintained on a permanent basis for all meetings.

§ 791.18 Public Availability of Meeting Records and Other Documents.

(a) The agency shall make promptly available to the public, in the Public Reference Room, the transcript, electronic recording, or minutes of any meeting, deleting any agenda item or any item of the testimony of a witness received at a closed meeting which the Board determined, pursuant to paragraph (c) of this Section, was exempt from disclosure under Section 791.12(a). The exemption or exemptions relied upon for any deleted information shall be reflected on any record or recording.

(b) Copies of any transcript, minutes or transcription of a recording, disclosing the identity of each speaker, shall be furnished to any person requesting such information in the form specified in paragraph (a) of this Section. Copies shall be furnished at the actual cost of duplication or transcription unless waived by the Secretary of the Board.

(c) Following each meeting or any portion of a meeting closed pursuant to § 791.12(a), the General Counsel or his designee, after consultation with the Secretary of the Board, shall determine which, if any, portions of the meeting transcript, electronic recording or minutes not otherwise available under 5 U.S.C. 552a (the Privacy Act) contain information which should be withheld pursuant to § 791.12(a). If, at a later time, the Board determines that there is no further justification for withholding any meeting record or other item of information from the public which has previously been withheld, then such information shall be made available to the public.

(d) Except for information determined by the Board to be exempt from disclosure pursuant to paragraph (c) of this Section, meeting records shall be promptly available to the public in the Public Reference Room. Meeting records include but are not limited to: the transcript, electronic recording or minutes of each meeting, as required by Section 791.17(a); the notice requirements of Section 791.13 and 791.14(c); and the General Counsel Certification along with the presiding officer's statement, as required by Section 791.16.

(e) These provisions do not affect the procedures set forth in Part 792, Subpart A, governing the inspection and copying of agency records, except that the exemptions set forth in Section 791.12(a) of this subpart and in 5 U.S.C. § 552b(c) shall govern in the case of a request made pursuant to Part 792, Subpart A, to copy or inspect the meeting records described in this Section. Any documents considered or mentioned at Board meetings may be obtained subject to the procedures set forth in Part 792, Subpart A.

Part 792

Requests for Information Under the Freedom of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information

Subpart A—The Freedom of Information Act

General Purpose

§ 792.01 What is the purpose of this subpart?

This subpart describes the procedures you must follow to obtain records from NCUA under the Freedom of Information Act (FOIA), (5 U.S.C. 552).

Records Publicly Available

§ 792.02 What records does NCUA make available to the public for inspection and copying?

Except for records that are exempt from public disclosure under FOIA as amended (5 U.S.C. 552) or are promptly published and copies are available for purchase, NCUA routinely makes the following five types of records available for you to inspect and copy:

(a) Final opinions, including concurring and dissenting opinions, and orders made in the adjudication of cases;

(b) Statements of policy and interpretations which have been adopted by the agency but not published in the FEDERAL REGISTER;

(c) Administrative staff manuals and instructions to staff that affect a member of the public;

(d) Copies of all records, regardless of form or format, which have been released after March 31, 1997, in response to a FOIA request and which, because of the nature of their subject matter, NCUA determines have been or are likely to become the subject of subsequent requests; and

(e) Indices of the documents referred to in this paragraph.

§ 792.03 How will I know which records to request?

NCUA maintains current indices providing identifying information for the public for any matter referred to in § 792.02, issued, adopted, or promulgated after July 4, 1967. The listing of material in an index is for the convenience of possible users and does not constitute a determination that all of the items listed will be disclosed. NCUA has determined that publication of the indices is unnecessary and impractical. You may obtain copies of indices by making a request to the Office of Administration, at NCUA, 1775 Duke Street, Alexandria, VA 22314–2387 or, as indicated, on the NCUA web site. The indices are available for public inspection and copying and are provided at their duplication cost. The indices are:

(a) NCUA Publications List: Manuals relating to general and technical information, booklets published by NCUA, and the Credit Union Directory. The NCUA Publications list is available on the NCUA web site.

(b) Directives Control Index: A list of statements of policy, NCUA Instructions, Bulletins, Letters to Credit Unions, and certain internal manuals.

(c) Popular FOIA Index: Records released in response to a FOIA request, that NCUA determines are likely to be the subject of subsequent requests because of the nature of their subject matter. The Popular FOIA Index will be available on the NCUA web site on or before December 31, 1999.

§ 792.04 How can I obtain these records?

You may obtain these types of records or information in the following ways:

(a) You may obtain copies of the records referenced in § 792.02 by obtaining the index referred to in § 792.03 and following the ordering instructions it contains, or by making a request to the FOIA Officer, NCUA, Office of General Counsel at 1775 Duke Street, Alexandria, Virginia 22314–3428.

(b) If they were created by NCUA on or after November 1, 1996, records referenced in § 792.02

are available on the NCUA web site, found at http://www.ncua.gov.

§ 792.05 What is the significance of records made available and indexed?

The records referred to in § 792.02 may be relied on, used, or cited as precedent by NCUA against a party, provided:

(a) The materials have been indexed and either made available or published; or

(b) The party has actual and timely notice of the materials' contents.

Records Available Upon Request

§ 792.06 Can I obtain other records?

Except with respect to records routinely made available under § 792.02 or published in the FEDERAL REGISTER, or to the extent that records are exempt under the FOIA, if you make a request for records in accordance with this subpart, NCUA will make such records available to you, including records maintained in electronic format, as long as you agree to pay the actual, direct costs.

§ 792.07 Where do I send my request?

(a) You must send your request to one of NCUA's Information Centers. The Central Office and Office of Inspector General are designated as Information Centers for the NCUA. The Freedom of Information Officer of the Office of General Counsel is responsible for the operation of the Information Center maintained at the Central Office. The Inspector General is responsible for the operation of the Inspector General Information Center.

(b) If you are seeking any NCUA record, other than those maintained by the Office of Inspector General, you should send your request to the Freedom of Information Officer at NCUA, Office of the General Counsel, 1775 Duke Street, Alexandria, Virginia 22314–3428. You may also send your request by electronic mail to *FOIA@NCUA.gov*.

(c) If you are seeking a record you think may be maintained by the NCUA Office of Inspector General, then you should send your request to the Inspector General, NCUA, 1775 Duke Street, Alexandria, Virginia 22314–3428.

§ 792.08 What must I include in my request?

(a) Your name, address and telephone number where you can be reached during normal business hours. If you would like us to respond to your FOIA request by electronic mail (e-mail), you should include your e-mail address.

(b) A reasonable description of the records you seek. A reasonable description is one that enables an NCUA employee, who is familiar with the subject area of the request, to locate the record with a reasonable amount of effort.

(c) A statement agreeing to pay all applicable fees or to pay fees up to a certain maximum amount, or requesting a fee reduction or waiver in accordance with § 792.27. If the actual fees are expected to exceed the maximum amount you indicate in your request, NCUA will contact you to see if you are willing to pay the estimated fees. If you do not want to pay the estimated fees, your request will be closed and no bill will be sent.

(d) If other than paper copy, you must identify the form and format of responsive information you are requesting.

§ 792.09 What if my request does not meet the requirements of this subpart?

NCUA need not accept or process your request if it does not comply with the requirements of this subpart. NCUA may return such a request to you with an explanation of the deficiency. You may then submit a corrected request, which will be treated as a new request.

§ 792.10 What will NCUA do with my request?

(a) On receipt of any request, the Information Center assigns it to the appropriate processing schedule, pursuant to paragraph (b) of this section. The date of receipt for any request, including one that is addressed incorrectly or that is referred to NCUA by another agency, is the date the appropriate Information Center actually receives the request.

(b) NCUA has a multi-track processing system. Requests for records that are readily identifiable by the Information Center and have already been cleared for public release may qualify for fast track processing. Requests which meets the requirements of § 792.18 will be processed on the expedited track. All other requests will be handled under normal processing procedures.

(c) The Information Center will make the determination whether a request qualifies for fast track processing or expedited track processing. You may contact the Information Center to learn to which track your request has been assigned. If your request has not qualified for fast track processing, you will have an opportunity to limit the scope of material requested to qualify for fast track processing. Limitations of requests must be in writing. If your request for expedited processing is not granted, you will be advised of your right to appeal.

(d) The Information Center will normally process requests in the order they are received in the separate processing tracks. However, in NCUA's discretion, a particular request may be processed out of turn.

(e) Upon a determination by the appropriate Information Center to comply with your initial request for records, the records will be made promptly available to you. If we notify you of a denial of your request, we will include the names and titles or positions of each person responsible for the denial.

(f) The Information Center will search for records responsive to your request and will generally include all records in existence at the time the search begins. If we use a different search cut-off date, we will inform you of that date.

§ 792.11 What kind of records are exempt from public disclosure?

(a) All records of NCUA or any officer, employee, or agent thereof, are confidential, privileged and exempt from disclosure, except as otherwise provided in this subpart, if they are:

(1) Records specifically authorized under criteria established by an Executive Order to be kept secret in the interest of national defense or foreign policy and are in fact properly classified pursuant to an Executive Order.

(2) Records related solely to NCUA internal personnel rules and practices. This exemption applies to internal rules or instructions which must be kept confidential in order to assure effective performance of the functions and activities for which NCUA is responsible and which do not materially affect members of the public. This exemption also applies to manuals and instructions to the extent that release of the information would permit circumvention of laws or regulations.

(3) Specifically exempted from disclosure by statute, where the statute either makes nondisclosure mandatory or establishes particular criteria for withholding information.

(4) Records which contain trade secrets and commercial or financial information which relate to the business, personal or financial affairs of any person or organization, are furnished to NCUA, and are confidential or privileged. This exemption includes, but is not limited to, various types of confidential sales and cost statistics, trade secrets, and names of key customers and personnel. Assurances of confidentiality given by staff are not binding on NCUA.

(5) Inter-agency or intra-agency memoranda or letters which would not be available by law to a private party in litigation with NCUA. This exemption preserves the existing freedom of NCUA officials and employees to engage in full and frank written or taped communications with each other and with officials and employees of other agencies. It includes, but is not limited to, inter-agency and intra-agency reports, memoranda, letters, correspondence, work papers, and minutes of meetings, as well as staff papers prepared for use within NCUA or in concert with other governmental agencies.

(6) Personnel, medical, and similar files (including financial files), the disclosure of which without written permission would constitute a clearly unwarranted invasion of personal privacy. Files exempt from disclosure include, but are not limited to:

(i) The personnel records of the NCUA;

(ii) The personnel records voluntarily submitted by private parties in response to NCUA's requests for proposals; and

(iii) Files containing reports, records or other material pertaining to individual cases in which disciplinary or other administrative action has been or may be taken.

(7) Records or information compiled for law enforcement purposes, but only to the extent that the production of such law enforcement records or information:

(i) Could reasonably be expected to interfere with enforcement proceedings;

(ii) Would deprive a person of a right to a fair trial or an impartial adjudication;

(iii) Could reasonably be expected to constitute an unwarranted invasion of personal privacy;

(iv) Could reasonably be expected to disclose the identity of a confidential source, including a state, local, or foreign agency or authority or any private institution which fur-

nished information on a confidential basis, and, in the case of a record or information compiled by a criminal law enforcement authority in the course of a criminal investigation on or by an agency conducting a lawful national security intelligence investigation, information furnished by the confidential source;

(v) Would disclose techniques and procedures for law enforcement investigation or prosecutions, or would disclose guidelines for law enforcement investigations or prosecutions if such disclosure could reasonably be expected to risk circumvention of the law; or

(vi) Could reasonably be expected to endanger the life or physical safety of any individual. This includes, but is not limited to, information relating to enforcement proceedings upon which NCUA has acted or will act in the future.

(8) Contained in or related to examination, operating or condition reports prepared by, or on behalf of, or for the use of NCUA or any agency responsible for the regulation or supervision of financial institutions. This includes all information, whether in formal or informal report form, the disclosure of which would harm the financial security of credit unions or would interfere with the relationship between NCUA and credit unions.

(b) We will provide any reasonably segregable portion of a requested record after deleting those portions that are exempt from disclosure under this section.

§ 792.12 How will I know what records NCUA has determined to be exempt?

As long as it is technically feasible and does not threaten an interest protected by the FOIA, we will:

(a) Mark the place where we redacted information from documents released to you and note the exemption that protects the information from public disclosure; or

(b) Make reasonable efforts to include with our response to you an estimate of the volume of information withheld.

§ 792.13 Can I get the records in different forms or formats?

NCUA will provide a copy of the record in any form or format requested, such as computer disk, if the record is readily reproducible by us in that form or format, but we will not provide more than one copy of any record.

§ 792.14 Who is responsible for responding to my request?

The Freedom of Information Officer or designee is responsible for making the initial determination whether to grant or deny a request for information submitted to the Central Office Information Center. The Inspector General or designee is responsible for making the initial determination whether to grant or deny a request for information submitted to the Inspector General Information Center. This official may refer a request to an NCUA employee who is familiar with the subject area of the request. Other NCUA staff members may aid the official by providing information, advice, recommending a decision, or implementing a decision, but no NCUA employee other than an authorized official may make the initial determination. Referral of a request by the official to an employee will not affect the time limitation imposed in § 792.15 unless the request involves an unusual circumstance as provided in § 792.16.

§ 792.15 How long will it take to process my request?

NCUA will respond to requests within 20 working days, except:

(a) Where the running of such time is suspended for payment of fees pursuant to § 792.26;

(b) In unusual circumstances, as defined in 5 U.S.C. 552(a)(6)(B) and § 792.16, the time limit may be extended for:

(1) An additional 10 working days as provided by written notice to you, stating the reasons for the extension and the date on which a determination will be sent; or

(2) Such alternative time period as mutually agreed by you and the Information Office,

when NCUA notifies you that the request cannot be processed in the specified time limit.

§ 792.16 What unusual circumstances can delay NCUA's response?

(a) In unusual circumstances, the time limits for responding to your request (or your appeal) may be extended by NCUA. If NCUA extends the time it will provide you with written notice, setting forth the reasons for such extension and the date on which a determination is expected to be dispatched. Our notice will not specify a date that would result in an extension for more than 10 working days, except as set forth in paragraph (c) of this section. The unusual circumstances that can delay NCUA's response to your request are:

(1) The need to search for, and collect the requested records from field facilities or other establishments that are separate from the office processing the request;

(2) The need to search for, collect, and appropriately examine a voluminous amount of separate and distinct records which are demanded in a single request; or

(3) The need for consultation, which will be conducted with all practicable speed, with another agency having substantial interest in the determination of the request or among two or more components of NCUA having a substantial interest in the subject matter.

(b) If you, or you and a group of others acting in concert, submit multiple requests that NCUA believes actually constitute a single request, which would otherwise satisfy the unusual circumstances criteria specified in this section, and the requests involve related matters, then NCUA may aggregate those requests and the provisions of § 792.15(b) will apply.

(c) If NCUA sends you an extension notice, it will also advise you that you can either limit the scope of your request so that it can be processed within the statutory time limit or agree to an alternative time frame for processing your request.

§ 792.17 What can I do if the time limit passes and I still have not received a response?

You can file suit against NCUA because you will be deemed to have exhausted your administrative remedies if NCUA fails to comply with the time limit provisions of this subpart. If NCUA can show that exceptional circumstances exist and that it is exercising due diligence in responding to your request, the court may retain jurisdiction and allow NCUA to complete its review of the records. In determining whether exceptional circumstances exist, the court may consider your refusal to modify the scope of your request or arrange an alternative time frame for processing after being given the opportunity to do so by NCUA, when it notifies you of the existence of unusual circumstances as set forth in § 792.16.

Expedited Processing

§ 792.18 What if my request is urgent and I cannot wait for the records?

You may request expedited processing of your request if you can show a compelling need for the records. In cases where your request for expedited processing is granted or if NCUA has determined to expedite the response, it will be processed as soon as practicable.

(a) To demonstrate a compelling need for expedited processing, you must provide a certified statement. The statement, certified by you to be true and correct to the best of your knowledge and belief, must demonstrate that:

(1) The failure to obtain the records on an expedited basis could reasonably be expected to pose an imminent threat to the life or physical safety of an individual; or

(2) The requester is a representative of the news media, as defined in § 792.20, and there is urgency to inform the public concerning actual or alleged NCUA activity.

(b) In response to a request for expedited processing, the Information Center will notify you of the determination within ten days of receipt of the request. If the Information Center denies your request for expedited processing, you may file an appeal pursuant to the procedures set forth in § 792.28, and NCUA will expeditiously respond to the appeal.

(c) The Information Center will normally process requests in the order they are received in the separate processing tracks. However, in NCUA's discretion, a particular request may be processed out of turn.

Fees

§ 792.19 How does NCUA calculate the fees for processing my request?

We will charge you our allowable direct costs, unless they are less than the cost of billing you. Direct costs means those expenditures that NCUA actually incurs in searching for, duplicating and reviewing documents to respond to a FOIA request. Search means all time spent looking for material that is responsive to a request, including page-by-page or line-by-line identification of material within documents. Searches may be done manually or by computer. Search does not include modification of an existing program or system that would significantly interfere with the operation of an automated information system. Review means examining documents to determine whether any portion should be withheld and preparing documents for disclosure. Fees are subject to change as costs increase. The current rate schedule is available on our web site at http://www.ncua.gov. We may contract with the private sector to locate, reproduce or disseminate records. NCUA will not contract out responsibilities that FOIA requires it to discharge, such as determining the applicability of an exemption, or determining whether to waive or reduce fees. The following labor and duplication rate calculations apply:

(a) NCUA will charge fees at the following rates for manual searches for and review of records:

(1) If search/review is done by clerical staff, the hourly rate for CU–5, plus 16% of that rate to cover benefits;

(2) If search/review is done by professional staff, the hourly rate for CU–13, plus 16% of that rate to cover benefits.

(b) NCUA will charge fees at the hourly rate for CU–13, plus 16% of that rate to cover benefits, plus the hourly cost of operating the computer for computer searches for records.

(c) NCUA will charge the following duplication fees:

(1) The per-page fee for paper copy reproduction of a document is $.05;

(2) The fee for documents generated by computer is the hourly fee for the computer operator, plus the cost of materials (computer paper, tapes, labels, etc.);

(3) If any other method of duplication is used, NCUA will charge the actual direct cost of duplication.

§ 792.20 What are the charges for each fee category?

The fee category definitions are:

(a) *Commercial use request* means a request from or on behalf of one who seeks information for a use or purpose that furthers the commercial, trade, or profit interests of the requester or the person on whose behalf the request is made.

(b) *Educational institution* means a preschool, an elementary or secondary school, an institution of undergraduate higher education, an institution of graduate higher education, an institution of professional education, and an institution of vocational education operating a program or programs of scholarly research.

(c) *Noncommercial scientific institution* means an institution that is not operated for a "commercial" purpose as that term is used in paragraph (a) of this section and is operated solely for the purpose of conducting scientific research, the results of which are not intended to promote any particular product or industry.

(d) *Representative of the news media* means any person actively gathering news for an entity that is organized and operated to publish or broadcast news to the public. Included within the meaning of public is the credit union community. The term news means information that is about current events or that would be of current interest to the public. You may consult the following chart to find the fees applicable to your request:

If your fee category is	You'll receive	And you'll be charged
Commercial use	0 hours free search	search time
	0 hours free review	review time
	0 free pages	duplication
Educational institution, noncommercial scientific institution, newsmedia.	Unlimited free search hours	duplication
	Unlimited free review hours	
	100 free pages	
All others	2 hours free search	search time
	Unlimited free review hours.	

If your fee category is	You'll receive	And you'll be charged
	100 free pages	duplication

§ 792.21 Will NCUA provide a fee estimate?

NCUA will notify you of the estimated amount if fees are likely to exceed $25, unless you have indicated in advance a willingness to pay fees as high as those anticipated. You will then have the opportunity to confer with NCUA personnel to reformulate the request to meet your needs at a lower cost.

§ 792.22 What will NCUA charge for other services?

Complying with requests for special services is entirely at the discretion of NCUA. NCUA will recover the full costs of providing such services to the extent it elects to provide them.

§ 792.23 Can I avoid charges by sending multiple, small requests?

You may not file multiple requests, each seeking portions of a document or similar documents, solely to avoid payment of fees. If this is done, NCUA may aggregate any such requests and charge you accordingly.

§ 792.24 Can NCUA charge me interest if I fail to pay my bill?

NCUA can assess interest charges on an unpaid bill starting on the 31st day following the date of the bill. If you fail to pay your bill within 30 days, interest will be at the rate prescribed in 31 U.S.C. 3717, and will accrue from the date of the billing.

§ 792.25 Will NCUA charge me if the records are not found or are determined to be exempt?

NCUA may assess fees for time spent searching and reviewing, even if it fails to locate the records or if records located are determined to be exempt from disclosure.

§ 792.26 Will I be asked to pay fees in advance?

NCUA will require you to give an assurance of payment or an advance payment only when:

(a) NCUA estimates or determines that allowable charges that you may be required to pay are likely to exceed $250. NCUA will notify you of the likely cost and obtain satisfactory assurance of full payment where you have a history of prompt payment of FOIA fees, or require an advance payment of an amount up to the full estimated charges in the case where you have no history of payment; or

(b) You have previously failed to pay a fee charged in a timely fashion. NCUA may require you to pay the full amount owed, plus any applicable interest, or demonstrate that you have, in fact, paid the fee, and to make an advance payment of the full amount of the estimated fee before we begin to process a new request or a pending request from you.

(c) If you are required to make an advance payment of fees, then the administrative time limits prescribed in § 792.16 will begin only after NCUA has received the fee payments described.

Fee Waiver or Reduction

§ 792.27 Can fees be reduced or waived?

You may request that NCUA waive or reduce fees if disclosure of the information you request is in the public interest because it is likely to contribute significantly to public understanding of the operations or activities of the government, and is not primarily in your commercial interest.

(a) NCUA will make a determination of whether the public interest requirement above is met based on the following factors:

(1) Whether the subject of the requested records concerns the operations or activities of the government;

(2) Whether the disclosure is likely to contribute to an understanding of government operations or activities;

(3) Whether disclosure of the requested information will contribute to public understanding; and

(4) Whether the disclosure is likely to contribute significantly to public understanding of government operations or activities,

(b) If the public interest requirement is met, NCUA will make a determination on the commer-

cial interest requirement based upon the following factors:

(1) Whether you have a commercial interest that would be furthered by the requested disclosure; and if so

(2) Whether the magnitude of your commercial interest is sufficiently large in comparison with the public interest in disclosure, that disclosure is primarily in your commercial interest.

(c) If the required public interest exists and your commercial interest is not primary in comparison, NCUA will waive or reduce fees.

(d) If you are not satisfied with our determination on your fee waiver or reduction request, you may submit an appeal to the General Counsel in accordance with § 792.28.

Appeals

§ 792.28 What if I am not satisfied with the response I receive?

If you are not satisfied with NCUA's response to your request, you can file an administrative appeal. Your appeal must be in writing and must be filed within 30 days from receipt of the initial determination (in cases of denials of an entire request, or denial of a request for fee waiver or reduction), or from receipt of any records being made available pursuant to the initial determination (in cases of partial denials.) In its response to your initial request, the Freedom of Information Act Officer or the Inspector General (or designee), will notify you that you may appeal any adverse determination to the Office of General Counsel. The General Counsel, or designee, as set forth in this paragraph, will:

(a) Make a determination with respect to any appeal within 20 days (excepting Saturdays, Sundays, and legal public holidays) after the receipt of such appeal. If, on appeal, the denial of the request for records is, in whole or in part, upheld, the Office of General Counsel will notify you of the provisions for judicial review of that determination under FOIA. Where you do not address your request or appeal to the proper official, the time limitations stated above will be computed from the receipt of the request or appeal by the proper official.

(b) The General Counsel is the official responsible for determining all appeals from initial determinations. In case of this person's absence, the appropriate officer acting in the General Counsel's stead will make the appellate determination, unless such officer was responsible for the initial determination, in which case the Vice-Chairman of the NCUA Board will make the appellate determination.

(c) All appeals should be addressed to the General Counsel in the Central Office and should be clearly identified as such on the envelope and in the letter of appeal by using the indicator "FOIA–APPEAL." Failure to address an appeal properly may delay commencement of the time limitation stated in paragraph (a)(1) of this section, to take account of the time reasonably required to forward the appeal to the Office of General Counsel.

§ 792.29 If I send NCUA confidential commercial information, can it be disclosed under FOIA?

(a) If you submit confidential commercial information to NCUA, it may be disclosed in response to a FOIA request in accordance with this section.

(b) For purposes of this section:

(1) *Confidential commercial information* means commercial or financial information provided to NCUA by a submitter that arguably is protected from disclosure under § 792.11(a)(4) because disclosure could reasonably be expected to cause substantial competitive harm.

(2) *Submitter* means any person or entity who provides business information, directly or indirectly, to NCUA.

(c) Submitters of business information must use good faith efforts to designate, by appropriate markings, either at the time of submission or at a reasonable time thereafter, those portions of their submissions deemed to be protected from disclosure under § 792.11(a)(4). Such a designation shall expire ten years after the date of submission.

(d) We will provide a submitter with written notice of a FOIA request or administrative appeal encompassing designated business information when:

(1) The information has been designated in good faith by the submitter as confidential commercial information deemed protected from disclosure under § 792.11(a)(4); or

(2) NCUA has reason to believe that the information may be protected from disclosure under § 792.11(a)(4).

(e) A copy of the notice to the submitter will also be provided to the FOIA requester.

(f) Through the notice described in paragraph (d) of this section, NCUA will afford the submitter a reasonable period of time within which to provide a detailed written statement of any objection to disclosure. The statement must describe why the information is confidential commercial information and why it should not be disclosed.

(g) Whenever we decide that we must disclose confidential commercial information over the objection of the submitter, we will send both the submitter and the FOIA requester, within a reasonable number of days prior to the specified disclosure date, a written notice which will include:

(1) A statement of the reasons for which the submitter's disclosure objection was not sustained; and

(2) A description of the information to be disclosed; and

(3) A specified disclosure date.

(h) If a requester brings suit to compel disclosure of confidential commercial information, we will promptly notify the submitter.

(i) The notice requirements of paragraph (d) of this section do not apply if:

(1) We determine that the information should not be disclosed;

(2) The information has been lawfully published or has been officially made available to the public;

(3) Disclosure of the information is required by law; or

(4) The designation made by the submitter in accordance with paragraph (c) of this section appears obviously frivolous; except that in such case, NCUA will provide the submitter with written notice of any final administrative decision to disclose the information within a reasonable number of days prior to the specified disclosure date.

Release of Exempt Information

§ 792.30 Is there a prohibition against disclosure of exempt records?

Except those authorized officials listed in § 792.14, or as provided in §§ 792.31–792.32, and subpart C of this part, no officer, employee, or agent of NCUA or of any federally-insured credit union shall disclose or permit the disclosure of any exempt records of NCUA to any person other than those NCUA or credit union officers, employees, or agents properly entitled to such information for the performance of their official duties.

§ 792.31 Can exempt records be disclosed to credit unions, financial institutions and state or federal agencies?

The NCUA Board, in its sole discretion, or any person designated by it in writing, may make available to certain governmental agencies and insured financial institutions copies of reports of examination and other documents, papers or information for their use, when necessary, in the performance of their official duties or functions. All reports, documents and papers made available pursuant to this paragraph shall remain the property of NCUA. No person, agency or employee shall disclose the reports or exempt records without NCUA's express written authorization.

§ 792.32 Can exempt records be disclosed to investigatory agencies?

The NCUA Board, or any person designated by it in writing, in its discretion and in appropriate circumstances, may disclose to proper federal or state authorities copies of exempt records pertaining to irregularities discovered in credit unions which may constitute either unsafe or unsound practices or violations of federal or state, civil or criminal law.

Subpart C—Production of Nonpublic Records and Testimony of NCUA Employees in Legal Proceedings

§ 792.40 What does this subpart prohibit?

This subpart prohibits the release of nonpublic records or the appearance of an NCUA employee to testify in legal proceedings except as provided in this subpart. Any person possessing nonpublic records may release them or permit their disclosure only as provided in this subpart.

(a) *Duty of NCUA employees.* (1) If an NCUA employee is served with a subpoena requiring him or her to appear as a witness or produce records,

the employee must promptly notify the Office of General Counsel. The General Counsel has the authority to instruct NCUA employees to refuse appearing as a witness or to withhold nonpublic records. The General Counsel may let an NCUA employee provide testimony, including expert or opinion testimony, if the General Counsel determines that the need for the testimony clearly outweighs contrary considerations.

(2) If a court or other appropriate authority orders or demands expert or opinion testimony or testimony beyond authorized subjects contrary to the General Counsel's instructions, an NCUA employee must immediately notify the General Counsel of the order and respectfully decline to comply. An NCUA employee must decline to answer questions on the grounds that this subpart forbids such disclosure and should produce a copy of this subpart, request an opportunity to consult with the Office of General Counsel, and explain that providing such testimony without approval may expose him or her to disciplinary or other adverse action.

(b) *Duty of persons who are not NCUA employees.* (1) If you are not an NCUA employee but have custody of nonpublic records and are served with a subpoena requiring you to appear as a witness or produce records, you must promptly notify the NCUA about the subpoena. Also, you must notify the issuing court or authority and the person or entity for whom the subpoena was issued of the contents of this subpart. Notice to the NCUA is made by sending a copy of the subpoena to the General Counsel of the NCUA, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314–3428. After receiving notice, the NCUA may advise the issuing court or authority and the person or entity for whom the subpoena was issued that this subpart applies and, in addition, may intervene, attempt to have the subpoena quashed or withdrawn, or register appropriate objections.

(2) After notifying the Office of General Counsel, you should respond to a subpoena by appearing at the time and place stated in the subpoena. Unless authorized by the General Counsel, you should decline to produce any records or give any testimony, basing your refusal on this subpart. If the issuing court or authority orders the disclosure of records or orders you to testify, you should continue to decline to produce records or testify and should advise the Office of General Counsel.

(c) *Penalties.* Anyone who discloses nonpublic records or gives testimony related to those records, except as expressly authorized by the NCUA or as ordered by a federal court after NCUA has had the opportunity to be heard, may face the penalties provided in 18 U.S.C. 641 and other applicable laws. Also, former NCUA employees, in addition to the prohibition contained in this subpart, are subject to the restrictions and penalties of 18 U.S.C. 207.

§ 792.41 When does this subpart apply?

This subpart applies if you want to obtain nonpublic records or testimony of an NCUA employee for legal proceedings. It doesn't apply to the release of records under the Freedom of Information Act (FOIA), 5 U.S.C. 552, or the Privacy Act, 5 U.S.C. 552a, or the release of records to federal or state investigatory agencies under § 792.32.

§ 792.42 How do I request nonpublic records or testimony?

(a) To request nonpublic records or the testimony of an NCUA employee, you must submit a written request to the General Counsel of the NCUA. If you serve a subpoena on the NCUA or an NCUA employee before submitting a written request and receiving a final determination, the NCUA will oppose the subpoena on the grounds that you failed to follow the requirements of this subpart. You may serve a subpoena as long as it is accompanied by a written request that complies with this subpart.

(b) To request nonpublic records that are part of the records of the Office of the Inspector General or the testimony of an NCUA employee on matters within the knowledge of the NCUA employee as a result of his or her employment with the Office of the Inspector General, you must submit a written request to the Office of the Inspector General. Your request will be handled in accordance with the provisions of this subpart except that the Inspector General will be responsible for those determinations that would otherwise be made by the General Counsel.

§ 792.43 What must my written request contain?

Your written request for records or testimony must include:

(a) The caption of the legal proceeding, docket number, and name of the court or other authority involved.

(b) A copy of the complaint or equivalent document setting forth the assertions in the case and

any other pleading or document necessary to show relevance.

(c) A list of categories of records sought, a detailed description of how the information sought is relevant to the issues in the legal proceeding, and a specific description of the substance of the testimony or records sought.

(d) A statement as to how the need for the information outweighs the need to maintain the confidentiality of the information and outweighs the burden on the NCUA to produce the records or provide testimony.

(e) A statement indicating that the information sought is not available from another source, such as a credit union's own books and records, other persons or entities, or the testimony of someone other than an NCUA employee, for example, retained experts.

(f) A description of all prior decisions, orders, or pending motions in the case that bear upon the relevance of the records or testimony you want.

(g) The name, address, and telephone number of counsel to each party in the case.

(h) An estimate of the amount of time you anticipate that you and other parties will need with each NCUA employee for interviews, depositions, or testifying.

§ 792.44 When should I make a request?

You should submit your request at least 45 days before the date that you need the records or testimony. If you want to have your request processed in less time, you must explain why you couldn't submit the request earlier and why you need expedited processing. If you are requesting the testimony of an NCUA employee, the NCUA expects you to anticipate your need for the testimony in sufficient time to obtain it by a deposition. The General Counsel may deny a request for testimony at a legal proceeding unless you explain why you could not use deposition testimony. The General Counsel will determine the location of a deposition taking into consideration the NCUA's interest in minimizing the disruption for an NCUA employee's work schedule and the costs and convenience of other persons attending the deposition.

§ 792.45 Where do I send my request?

You must send your request or subpoena for records or testimony to the attention of the General Counsel for the NCUA, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314–3428. You must send your request or subpoena for records or testimony from the Office of the Inspector General to the attention of the NCUA Inspector General, 1775 Duke Street, Alexandria, Virginia 22314–3428.

§ 792.46 What will the NCUA do with my request?

(a) *Factors the NCUA will consider.* The NCUA may consider various factors in reviewing a request for nonpublic records or testimony of NCUA employees, including:

(1) Whether disclosure would assist or hinder the NCUA in performing its statutory duties or use NCUA resources unreasonably, including whether responding to the request will interfere with NCUA employees' ability to do their work.

(2) Whether disclosure is necessary to prevent the perpetration of a fraud or other injustice in the matter or if you can get the records or testimony you want from sources other than the NCUA.

(3) Whether the request is unduly burdensome.

(4) Whether disclosure would violate a statute, executive order, or regulation, for example, the Privacy Act, 5 U.S.C. 552a.

(5) Whether disclosure would reveal confidential, sensitive or privileged information, trade secrets or similar, confidential commercial or financial information, or would otherwise be inappropriate for release and, if so, whether a confidentiality agreement or protective order as provided in § 792.48(a) can adequately limit the disclosure.

(6) Whether the disclosure would interfere with law enforcement proceedings, compromise constitutional rights, or hamper NCUA research or investigatory activities.

(7) Whether the disclosure could result in NCUA appearing to favor one litigant over another.

(8) Any other factors the NCUA determines to be relevant to the interests of the NCUA.

(b) *Review of your request.* The NCUA will process your request in the order it is received. The NCUA will try to respond to your request within 45 days, but this may vary depending on the scope of your request.

(c) *Final determination.* The General Counsel makes the final determination on requests for nonpublic records or NCUA employee testimony. All final determinations are in the sole discretion of the General Counsel. The General Counsel will notify you and the court or other authority of the final determination of your request. In considering your request, the General Counsel may contact you to inform you of the requirements of this subpart, ask that the request or subpoena be modified or withdrawn, or may try to resolve the request or subpoena informally without issuing a final determination. You may seek judicial review of the final determination under the Administrative Procedure Act. 5 U.S.C. 702.

§ 792.47 If my request is granted, what fees apply?

(a) *Generally.* You must pay any fees associated with complying with your request, including copying fees for records and witness fees for testimony. The General Counsel may condition the production of records or appearance for testimony upon advance payment of a reasonable estimate of the fees.

(b) *Fees for records.* You must pay all fees for searching, reviewing and duplicating records produced in response to your request. The fees will be the same as those charged by the NCUA under its Freedom of Information Act regulations, § 792.19.

(c) *Witness fees.* You must pay the fees, expenses, and allowances prescribed by the court's rules for attendance by a witness. If no such fees are prescribed, the local federal district court rule concerning witness fees, for the federal district court closest to where the witness appears, will apply. For testimony by current NCUA employees, you must pay witness fees, allowances, and expenses to the General Counsel by check made payable to the "National Credit Union Administration" within 30 days from receipt of NCUA's billing statement. For the testimony of a former NCUA employee, you must pay witness fees, allowances, and expenses directly to the former employee, in accordance with 28 U.S.C. 1821 or other applicable statutes.

(d) *Certification of records.* The NCUA may authenticate or certify records to facilitate their use as evidence. If you require authenticated records, you must request certified copies at least 45 days before the date they will be needed. The request should be sent to the General Counsel. You will be charged a certification fee of $5.00 per document.

(e) *Waiver of fees.* A waiver or reduction of any fees in connection with the testimony, production, or certification or authentication of records may be granted in the discretion of the General Counsel. Waivers will not be granted routinely. If you request a waiver, your request for records or testimony must state the reasons why a waiver should be granted.

§ 792.48 If my request is granted, what restrictions apply?

(a) *Records.* The General Counsel may impose conditions or restrictions on the release of nonpublic records, including a requirement that you obtain a protective order or execute a confidentiality agreement with the other parties in the legal proceeding that limits access to and any further disclosure of the nonpublic records. The terms of a confidentiality agreement or protective order must be acceptable to the General Counsel. In cases where protective orders or confidentiality agreements have already been executed, the NCUA may condition the release of nonpublic records on an amendment to the existing protective order or confidentiality agreement.

(b) *Testimony.* The General Counsel may impose conditions or restrictions on the testimony of NCUA employees, including, for example, limiting the areas of testimony or requiring you and the other parties to the legal proceeding to agree that the transcript of the testimony will be kept under seal or will only be used or made available in the particular legal proceeding for which you requested the testimony. The General Counsel may also require you to provide a copy of the transcript of the testimony to the NCUA at your expense.

§ 792.49 Definitions.

Legal proceedings means any matter before any federal, state or foreign administrative or judicial authority, including courts, agencies, commissions, boards or other tribunals, involving such proceedings as lawsuits, licensing matters, hearings, trials, discovery, investigations, mediation or arbitration. When the NCUA is a party to a legal proceeding, it will be subject to the applicable

rules of civil procedure governing production of documents and witnesses, however, this subpart will still apply to the testimony of former NCUA employees.

NCUA employee means current and former officials, members of the Board, officers, directors, employees and agents of the National Credit Union Administration, including contract employees and consultants and their employees. This definition does not include persons who are no longer employed by the NCUA and are retained or hired as expert witnesses or agree to testify about general matters, matters available to the public, or matters with which they had no specific involvement or responsibility during their employment.

Nonpublic records means any NCUA records that are exempt from disclosure under § 792.11, the NCUA regulations implementing the provisions of the Freedom of Information Act. For example, this means records created in connection with NCUA's examination and supervision of insured credit unions, including examination reports, internal memoranda, and correspondence, and, also, records created in connection with NCUA's enforcement and investigatory responsibilities.

Subpoena means any order, subpoena for records or other tangible things or for testimony, summons, notice or legal process issued in a legal proceeding.

Testimony means any written or oral statements made by an individual in connection with a legal proceeding including personal appearances in court or at depositions, interviews in person or by telephone, responses to written interrogatories or other written statements such as reports, declarations, affidavits, or certifications or any response involving more than the delivery of records.

Subpart D—Security Procedures for Classified Information

§ 792.50 Program.

(a) The NCUA's Chief Financial Officer is designated as the person responsible for implementation and oversight of NCUA's program for maintaining the security of confidential information regarding national defense and foreign relations. The Chief Financial Officer receives questions, suggestions and complaints regarding all elements of this program. The Chief Financial Officer is solely responsible for changes to the program and assures that the program is consistent with legal requirements.

(b) The Chief Financial Officer is the Agency's official contact for declassification requests regardless of the point of origin of such requests.

§ 792.51 Procedures.

(a) *Mandatory review.* All declassification requests made by a member of the public, by a government employee or by an agency shall be handled by the Chief Financial Officer or the Chief Financial Officer's designee. Under no circumstances shall the Chief Financial Officer refuse to confirm the existence or nonexistence of a document under the Freedom of Information Act or the mandatory review provisions of other applicable law, unless the fact of its existence or nonexistence would itself be classifiable under applicable law. Although NCUA has no authority to classify or declassify information, it occasionally handles information classified by another agency. The Chief Financial Officer shall refer all declassification requests to the agency that originally classified the information. The Chief Financial Officer or the Chief Financial Officer's designee shall notify the requesting person or agency that the request has been referred to the originating agency and that all further inquiries and appeals must be made directly to the other agency.

(b) *Handling and safeguarding national security information.* All information classified "Top Secret," "Secret," and "Confidential" shall be delivered to the Chief Financial Officer or the Chief Financial Officer's designee immediately upon receipt. The Chief Financial Officer shall advise those who may come into possession of such information of the name of the current designee. If the Chief Financial Officer is unavailable, the designee shall lock the documents, unopened, in the combination safe located in the Office of the Chief Financial Officer. If the Chief Financial Officer or the Chief Financial Officer's designee is unavailable to receive such documents, the documents shall be delivered to the Director of the Personnel Office who shall lock them, unopened, in the combination safe in the Personnel Office. Under no circumstances shall classified materials that cannot be delivered to the Chief Financial Officer be stored other than in the two designated safes.

(c) *Storage.* All classified documents shall be stored in the combination safe located in the Chief Financial Officer's Office, except as provided in paragraph (b) of this Section. The combination shall be known only to the Chief Financial Officer

and the Chief Financial Officer's designee holding the proper security clearance.

(d) *Employee Education.* The Chief Financial Officer shall send a memo to every NCUA employee who (1) has a security clearance and (2) may handle classified materials. This memo shall describe NCUA procedures for handling, reproducing and storing classified documents. The Chief Financial Officer shall require each such employee to review Executive Order 12356.

(e) *Agency Terminology.* The National Credit Union Administration's Central Office shall use the terms "Top Secret," "Secret" or "Confidential" only in relation to materials classified for national security purposes.

Subpart E—The Privacy Act

§ 792.52 Scope.

This Subpart governs requests made of NCUA under the Privacy Act (5 U.S.C. § 552a). The regulation applies to all records maintained by NCUA which contain personal information about an individual and some means of identifying the individual, and which are contained in a system of records from which information may be retrieved by use of an identifying particular; sets forth procedures whereby individuals may seek and gain access to records concerning themselves and request amendments of those records; and sets forth requirements applicable to NCUA employees' maintaining, collecting, using, or disseminating such records.

§ 792.53 Definitions.

For purposes of this Subpart:

(a) "Individual" means a citizen of the United States or an alien lawfully admitted for permanent residence.

(b) "Maintain" includes maintain, collect, use, or disseminate.

(c) "Record" means any item, collection, or grouping of information about an individual that is maintained by NCUA, and that contains the name, or an identifying number, symbol, or other identifying particular assigned to the individual.

(d) "System of records" means a group of any records under NCUA's control from which information is retrieved by the name of the individual or by some identifying number, symbol, or other identifying particular assigned to the individual.

(e) "Routine use" means, with respect to the disclosure of a record, the use of such record for a purpose which is compatible with the purpose for which it was collected.

(f) "Statistical record" means a record in a system of records maintained for statistical research or reporting purposes only and not used in whole or in part in making any determination about an identifiable individual, except as provided by Section 8 of Title 13 of the United States Code.

§ 792.54 Procedures for requests pertaining to individual records in a system of records.

(a) An individual seeking notification of whether a system of records contains a record pertaining to that individual, or an individual seeking access to information or records pertaining to that individual which are available under the Privacy Act shall present a request to the NCUA official identified in the access procedure section of the "Notice of Systems of Records" published in the *FEDERAL REGISTER* which describes the system of records to which the individual's request relates. An individual who does not have access to the *FEDERAL REGISTER* and who is unable to determine the appropriate official to whom a request should be submitted may submit a request to the Privacy Officer, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428, in which case the request will then be referred to the appropriate NCUA official and the date of receipt of the request will be determined as the date of receipt by the official.

(b) In addition to meeting the identification requirements set forth in § 792.55, an individual seeking notification or access, either in person or by mail, shall describe the nature of the record sought, the approximate dates covered by the record, and the system in which it is thought to be included, as described in the "Notice of Systems of Records" published in the *FEDERAL REGISTER.*

§ 792.55 Times, places, and requirements for identification of individuals making requests and identification of records requested.

(a) The following standards are applicable to an individual submitting requests either in person or by mail under § 792.54:

(1) If not personally known to the NCUA official responding to the request, an individual seeking access to records about that individual in person shall establish identity by the presentation of a single document bearing a photograph (such as a passport or identification

badge) or by the presentation of two items of identification which do not bear a photograph but do bear both a name and address (such as a driver's license or credit card);

(2) An individual seeking access to records about that individual by mail may establish identity by a signature, address, date of birth, employee identification number if any, and one other identifier such as a photocopy of driver's license or other document. If less than all of this requisite identifying information is provided, the NCUA official responding to the request may require further identifying information prior to any notification or responsive disclosure.

(3) An individual seeking access to records about himself by mail or in person, who cannot provide the required documentation or identification, may provide an unsworn declaration subscribed to as true under penalty of perjury.

(b) The parent or guardian of a minor or a person judicially determined to be incompetent shall, in addition to establishing identity of the minor or other person as required in paragraph (a) of this section, furnish a copy of a birth certificate showing parentage or a court order establishing guardianship.

(c) An individual may request by telephone notification of the existence of and access to records about that individual and contained in a system of records. In such a case, the NCUA official responding to the request shall require, for the purpose of comparison and verification of identity, at least two items of identifying information (such as date of birth, home address, social security number) already possessed by the NCUA. If the requisite identifying information is not provided, or otherwise at the discretion of the responsible NCUA official, an individual may be required to submit the request by mail or in person in accordance with paragraph (a) of this Section.

(d) An individual seeking to review records about that individual may be accompanied by another person of their own choosing. In such cases, the individual seeking access shall be required to furnish a written statement authorizing discussion of that individual's records in the accompanying person's presence.

(e) In addition to the requirements set forth in paragraphs (a), (b) and (c) of this Section, the published "Notice of Systems of Records" for individual systems may include further requirements of identification where necessary to retrieve the individual records from the system.

§ 792.56 Notice of existence of records, access decisions and disclosure of requested information; time limits.

(a) The NCUA official identified in the record access procedure section of the "Notice of Systems of Records" and identified in accordance with § 792.54(a), by an individual seeking notification of, or access to, a record, shall be responsible: (1) for determining whether access is available under the Privacy Act; (2) for notifying the requesting individual of that determination; and (3) for providing access to information determined to be available. In the case of an individual access request made in person, information determined to be available shall be provided by allowing a personal review of the record or portion of a record containing the information requested and determined to be available, and the individual shall be allowed to have a copy of all or any portion of available information made in a form comprehensible to him. In the case of an individual access request made by mail, information determined to be available shall be provided by mail, unless the individual has requested otherwise.

(b) The following time limits shall be applicable to the required determinations, notification and provisions of access set forth in paragraph (a) of this Section:

(1) A request concerning a single system of records which does not require consultation with or requisition of records from another agency will be responded to within 20 working days after receipt of the request.

(2) A request requiring requisition of records from or consultation with another agency will be responded to within 30 working days of receipt of the request.

(3) If a request under paragraphs (b)(1) or (2) of this section presents unusual difficulties in determining whether the records involved are exempt from disclosure, the Privacy Act Officer, in the Office of General Counsel, may extend the time period established by the regulations by 10 working days.

(c) Nothing in this Section shall be construed to allow an individual access to any information

compiled in reasonable anticipation of a civil action or proceeding, or any information exempted from the access provisions of the Privacy Act.

§ 792.57 Special procedures: Information furnished by other agencies; medical records.

(a) When a request for records or information from NCUA includes information furnished by other Federal agencies, the NCUA official responsible for action on the request shall consult with the appropriate agency prior to making a decision to disclose or refuse access to the record, but the decision whether to disclose the record shall be made in the first instance by the NCUA official.

(b) When an individual requests medical records concerning himself, the NCUA official responsible for action on the request may advise the individual that the records to be released will be provided first to a physician designated in writing by the individual. The physician will provide the records to the individual.

§ 792.58 Requests for correction or amendment to a record; administrative review of requests.

(a) An individual may request amendment of a record concerning that individual by addressing a request, either in person or by mail, to the NCUA official identified in the "contesting record procedures" section of the "Notice of Systems of Records" published in the *FEDERAL REGISTER* and describing the system of records which contains the record sought to be amended. The request must indicate the particular record involved, the nature of the correction sought, and the justification for the correction or amendment. Requests made by mail should be addressed to the responsible NCUA official at the address specified in the "Notice of Systems of Records" describing the system of records which contains the contested record. An individual who does not have access to NCUA's "Notice of Systems of Records," and to whom the appropriate address is otherwise unavailable, may submit a request to the Privacy Act Officer, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia, 22314–3428, in which case the request will then be referred to the appropriate NCUA official. The date of receipt of the request will be determined as of the date of receipt by that official.

(b) Within 10 working days of receipt of the request, the appropriate NCUA official shall advise the individual that the request has been received. The appropriate NCUA official shall then promptly (under normal circumstances, not later than 30 working days after receipt of the request) advise the individual that the record is to be amended or corrected, or inform the individual of rejection of the request to amend the record, the reason for the rejection, and the procedures established by § 792.27 for the individual to request a review of that rejection.

§ 792.59 Appeal of initial determination.

(a) A rejection, in whole or in part, of a request to amend or correct a record may be appealed to the General Counsel within 30 working days of receipt of notice of the rejection. Appeals shall be in writing, and shall set forth the specific item of information sought to be corrected and the documentation justifying the correction. Appeals shall be addressed to the Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Appeals shall be decided within 30 working days of receipt unless the General Counsel, for good cause, extends such period for an additional 30 working days.

(b) Within the time limits set forth in paragraph (a) of this Section, the General Counsel shall either advise the individual of a decision to amend or correct the record, or advise the individual of a determination that an amendment or correction is not warranted on the facts, in which case the individual shall be advised of the right to provide for the record a "Statement of Disagreement" and of the right to further appeal pursuant to the Privacy Act. For records under the jurisdiction of the Office of Personnel Management, appeals will be made pursuant to that agency's regulations.

(c) A statement of disagreement may be furnished by the individual. The statement must be sent, within 30 days of the date of receipt of the notice of General Counsel refusal to authorize correction, to the General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Upon receipt of a statement of disagreement in accordance with this Section, the General Counsel shall take steps to ensure that the statement is included in the system of records containing the disputed item and that the

original item is so marked to indicate that there is a statement of dispute and where, within the system of records, that statement may be found.

(d) When a record has been amended or corrected or a statement of disagreement has been furnished, the system manager for the system of records containing the record shall, within 30 days thereof, advise all prior recipients of information to which the amendment or statement of disagreement relates whose identity can be determined by an accounting made as required by the Privacy Act of 1974 or any other accounting previously made, of the amendment or statement of disagreement. When a statement of disagreement has been furnished, the system manager shall also provide any subsequent recipient of a disclosure containing information to which the statement relates with a copy of the statement and note the disputed portion of the information disclosed. A concise statement of the reasons for not making the requested amendment may also be provided if deemed appropriate.

(e) If access is denied because of an exemption, the individual will be notified of the right to appeal that determination to the General Counsel within 30 days after receipt. Appeals will be determined within 20 working days.

§ 792.60 Disclosure of record to person other than the individual to whom it pertains.

No record or item of information concerning an individual which is contained in a system of records maintained by NCUA shall be disclosed by any means of communication to any person, or to another agency, without the prior written consent of the individual to whom the record or item of information pertains, unless the disclosure would be—

(a) To an employee of the NCUA who has need for the record in the performance of duty;

(b) Required by the Freedom of Information Act;

(c) For a routine use as described in the "Notice of Systems of Records," published in the *FEDERAL REGISTER*, which describes the system of records in which the record or item of information is contained;

(d) To the Bureau of the Census for purposes of planning or carrying out a census or survey or related activity pursuant to the provisions of Title 13 of the United States Code;

(e) To a recipient who has provided the NCUA with advance adequate written assurance that the record or item will be used solely as a statistical research or reporting record, and the record is to be transferred in a form that is not individually identifiable;

(f) To the National Archives and Records Administration as a record or item which has sufficient historical or other value to warrant its continued preservation by the United States Government, or for evaluation by the Archivist of the United States or the designee of the Archivist to determine whether the record has such value;

(g) To another agency or to an instrumentality of any governmental jurisdiction within or under the control of the United States for a civil or criminal law enforcement activity if the activity is authorized by law, and if the head of the agency or instrumentality has made a written request to NCUA specifying the particular portion desired and the law enforcement activity for which the record or item is sought;

(h) To a person pursuant to a showing of compelling circumstances affecting the health or safety of an individual if, upon such disclosure, notification is transmitted to the last known address of such individual;

(i) To either House of Congress, or, to the extent of matter within its jurisdiction, any committee or subcommittee thereof, any joint committee of Congress or subcommittee of any such joint committee;

(j) To the Comptroller General, or any of his authorized representatives, in the course of the performance of the duties of the General Accounting Office; or

(k) Pursuant to the order of a court of competent jurisdiction; or

(l) To a consumer reporting agency in accordance with Section 3711(f) of Title 31 of the United States Code (31 U.S.C. § 3711(f)).

§ 792.61 Accounting for disclosures.

(a) Each system manager identified in the "Notice of Systems of Records" as published in the *FEDERAL REGISTER* for each system of records maintained by the NCUA, shall establish a system of accounting for all disclosures of information or records concerning individuals and contained in the system of records, made outside NCUA. Accounting procedures may be established in the least expensive and most convenient form that will permit the system manager to advise individuals, promptly upon request, of the persons or

agencies to which records concerning them have been disclosed.

(b) Accounting records, at a minimum, shall include the information disclosed, the name and address of the person or agency to whom disclosure was made, and the date of disclosure. When records are transferred to the National Archives and Records Administration for storage in records centers, the accounting pertaining to those records shall be transferred with the records themselves.

(c) Any accounting made under this Section shall be retained for at least five years or the life of the record, whichever is longer, after the disclosure for which the accounting is made.

§ 792.62 Requests for accounting for disclosures.

At the time of the request for access or correction or at any other time, an individual may request an accounting of disclosures made of the individual's record outside the NCUA. Request for accounting shall be directed to the system manager. Any available accounting, whether kept in accordance with the requirements of the Privacy Act or under procedures established prior to September 27, 1975, shall be made available to the individual, except that an accounting need not be made available if it relates to: (a) a disclosure made pursuant to the Freedom of Information Act (5 U.S.C. 552); (b) a disclosure made within the NCUA; (c) a disclosure made to a law enforcement agency pursuant to 5 U.S.C. 552a(b)(7); (d) a disclosure which has been exempted from the provisions of 5 U.S.C. 552a(c)(3) pursuant to 5 U.S.C. 552a(j) or (k).

§ 792.63 Collection of information from individuals: information forms.

(a) The system manager, as identified in the "Notice of Systems of Records" published in the *FEDERAL REGISTER* for each system of records maintained by the Administration, shall be responsible for reviewing all forms developed and used to collect information from or about individuals for incorporation into the system of records.

(b) The purpose of the review shall be to eliminate any requirement for information that is not relevant and necessary to carry out an NCUA function and to accomplish the following objectives:

(1) To ensure that no information concerning religion, political beliefs or activities, association memberships (other than those required for a professional license), or the exercise of other First Amendment rights is required to be disclosed unless such requirement of disclosure is expressly authorized by statute or is pertinent to and within the scope of any authorized law enforcement activity;

(2) To ensure that the form or accompanying statement makes clear to the individual which information by law must be disclosed and the authority for that requirement, and which information is voluntary;

(3) To ensure that the form or accompanying statement makes clear the principal purpose or purposes for which the information is being collected, and states concisely the routine uses that will be made of the information;

(4) To ensure that the form or accompanying statement clearly indicates to the individual the existing rights, benefits or privileges not to provide all or part of the requested information; and

(5) To ensure that any form requesting disclosure of a social security number, or an accompanying statement, clearly advises the individual of the statute or regulation requiring disclosure of the number, or clearly advises the individual that disclosure is voluntary and that no consequence will flow from a refusal to disclose it, and the uses that will be made of the number whether disclosed mandatorily or voluntarily.

(c) Any form which does not meet the objectives specified in the Privacy Act and this Section shall be revised to conform thereto.

§ 792.64 Contracting for the operation of a system of records.

(a) No NCUA component shall contract for the operation of a system of records by or on behalf of the Agency without the express approval of the NCUA Board.

(b) Any contract which is approved shall continue to ensure compliance with the requirements of the Privacy Act. The contracting component shall have the responsibility for ensuring that the contractor complies with the contract requirements relating to the Privacy Act.

§ 792.65 Fees.

(a) Fees pursuant to 5 U.S.C. 552a(f)(5) shall be assessed for actual copies of records provided to individuals on the following basis, unless the NCUA official determining access waives the fee because of the inability of the individual to pay or the cost of collecting the fee exceeds the fee:

(1) For copies of documents provided, copy fees as stated in NCUA's current FOIA fee schedule; and

(2) For copying information, if any, maintained in nondocument form, the direct cost to NCUA may be assessed.

(b) If it is determined that access fees chargeable under this Section will amount to more than $25, and the individual has not indicated in advance willingness to pay fees as high as are anticipated, the individual shall be notified of the amount of the anticipated fees before copies are made, and the individual's access request shall not be considered to have been received until receipt by NCUA of written agreement to pay.

§ 792.66 Exemptions.

(a) NCUA maintains four systems of records that are exempted from some provisions of the Privacy Act. In paragraph (b) of this Section, those systems of records are identified by System Name and System Number, as stated in the NCUA's "Notice of Systems of Records," published in the *FEDERAL REGISTER*. The provisions from which each system is exempted and the reasons therefor are also set forth.

(b)(1) System NCUA–1, entitled "Employee Suitability Security Investigations Containing Adverse Information," consists of adverse information about NCUA employees that had been obtained as a result of routine U.S. Office of Personnel Management (OPM) security Investigations. To the extent that NCUA maintains records in this system pursuant to OPM guidelines that may require retrieval of information by use of individual identifiers, those records are encompassed by and included in the OPM Central system of records number Central-9 entitled, "Personnel Investigations Records," and thus are subject to the exemptions promulgated by OPM. Additionally, in order to ensure the protection of properly confidential sources, particularly as to those records which are not maintained pursuant to such Office of Personnel Management requirements, the records in these systems of records are exempted, pursuant to Section (k)(5) of the Privacy Act (5 U.S.C. 552a(k)(5)), from Section (d) of the Act (5 U.S.C. 552a(d)). To the extent that disclosure of a record would reveal the identity of a confidential source, NCUA need not grant access to that record by its subject. Information which would reveal a confidential source shall, however, whenever possible, be extracted or summarized in a manner which protects the source and the summary or extract shall be provided to the requesting individual.

(2) System NCUA–8, entitled, "Investigative Reports Involving Any Crime or Suspicious Activity Against a Credit Union, NCUA," consists of investigatory or enforcement records about individuals suspected of involvement in violations of laws or regulations, whether criminal or administrative. These records are maintained in an overall context of general investigative information concerning crimes against credit unions. To the extent that individually identifiable information is maintained, however, for purposes of protecting the security of any investigations by appropriate law enforcement authorities and promoting the successful prosecution of all actual criminal activity, the records in this system are exempted, pursuant to Section k(2) of the Privacy Act (5 U.S.C. 552a (k)(2)), from Sections (c)(3), and (d)). NCUA need not make an accounting of previous disclosures of a record in this system of records available to its subject, and NCUA need not grant access to any records in this system of records by their subject. Further, whenever individuals request records about themselves and maintained in this system of records, the NCUA shall, to the extent necessary to realize the above-stated purposes, neither confirm nor deny the existence of the records but shall advise the individuals only that no records available to them pursuant to the Privacy Act of 1974 have been identified. However, should review of the record reveal that the information contained therein has been used or is being used to deny the individuals any right, privilege or benefit for which they are eligible or to which they would otherwise be entitled under Federal law, the individuals shall be advised of the existence of the information and shall be provided the information, except to the extent disclosure would identify a confidential source. Information which would identify a confidential source shall, if possible, be extracted or summarized in a manner which protects the source and the summary or extract shall be provided to the requesting individual.

(3) System NCUA–11, entitled, "Office of Inspector General (OIG) Investigative Records," consists of OIG records of closed and pending investigations of individuals alleged to have been involved in criminal violations. The records in this system are exempted pursuant to Sections (k)(2) of the Privacy Act, 5 U.S.C. 552a(k)(2), from sections (c)(3); (d); (e)(1); (e)(4)(G); (e)(4)(H); (e)(4)(I); and (f). The records in this system are also exempted pursuant to Section (j)(2) of the Privacy Act, 5 U.S.C. 552a(j)(2), from sections (c)(3); (c)(4); (d); (e)(1); (e)(2); (e)(3); and (g).

(4) System NCUA–13, entitled, "Litigation Case Files," consists of investigatory materials compiled for law enforcement purposes. Records in the Litigation Case Files system are used in connection with the execution of NCUA's legal and enforcement responsibilities. Because the system covers investigatory materials compiled for law enforcement purposes, it is eligible for exemption under subsection (k)(2) of the Privacy Act. 5 U.S.C. 552a(k)(2). The Litigation Case Files system is exempt from subsections (c)(3), (d), (e)(1), (e)(4)(G), (H), (I) and (f) of the Privacy Act. 5 U.S.C. 552a (c)(3), (d), (e)(1), (e)(4)(G), (H), (I) and (f). However, if an individual is denied any right, privilege, or benefit to which he would otherwise be entitled by federal law, or for which he otherwise would be eligible, as a result of the maintenance of such records, the records or information will be made available to him, provided the identity of a confidential source is not disclosed.

(c) For purposes of this Section, a "confidential source" means a source who furnished information to the Government under an express promise that the identity of the source would remain confidential, or, prior to September 27, 1976, under an implied promise that the identity of the source would be held in confidence.

§ 792.67 Security of systems of records.

(a) Each system manager, with the approval of the head of that Office, shall establish administrative and physical controls to ensure the protection of a system of records from unauthorized access or disclosure and from physical damage or destruction. The controls instituted shall be proportional to the degree of sensitivity of the records, but at a minimum must ensure: that records are enclosed in a manner to protect them from public view; that the area in which the records are stored is supervised during all business hours to prevent unauthorized personnel from entering the area or obtaining access to the records; and that the records are inaccessible during nonbusiness hours.

(b) Each system manager, with the approval of the head of that Office, shall adopt access restriction to insure that only those individuals within the agency who have a need to have access to the records for the performance of duty have access. Procedures shall also be adopted to prevent accidental access to or dissemination of records.

§ 792.68 Use and collection of Social Security numbers.

The head of each NCUA Office shall take such measures as are necessary to ensure that employees authorized to collect information from individuals are advised that individuals may not be required without statutory or regulatory authorization to furnish Social Security numbers, and that individuals who are requested to provide Social Security numbers voluntarily must be advised that furnishing the number is not required and that no penalty or denial of benefits will flow from the refusal to provide it.

§ 792.69 Training and employee standards of conduct with regard to privacy.

(a) The Director of the Office of Human Resources, with advice from the General Counsel, is responsible for training NCUA employees in the obligations imposed by the Privacy Act and this subpart.

(b) The head of each NCUA Office shall be responsible for assuring that employees subject to that person's supervision are advised of the provisions of the Privacy Act, including the criminal penalties and civil liabilities provided therein, and that such employees are made aware of their responsibilities to protect the security of personal information, to assure its accuracy, relevance, timeliness, and completeness, to avoid unauthorized disclosure either orally or in writing, and to ensure that no information system concerning individuals, no matter how small or specialized, is maintained without public notice.

(c) With respect to each system of records maintained by NCUA, Agency employees shall:

(1) Collect no information of a personal nature from individuals unless authorized to collect it to achieve a function or carry out an NCUA responsibility;

(2) Collect from individuals only that information which is necessary to NCUA functions or responsibilities;

(3) Collect information, wherever possible, directly from the individual to whom it relates;

(4) Inform individuals from whom information is collected of the authority for collection, the purposes thereof, the routine uses that will be made of the information, and the effects, both legal and practical, of not furnishing the information;

(5) Not collect, maintain, use, or disseminate information concerning an individual's religious or political beliefs or activities or his membership in associations or organizations, unless (i) the individual has volunteered such information for his own benefit; (ii) the information is expressly authorized by statute to be collected, maintained, used, or disseminated; or (iii) activities involved are pertinent to and within the scope of an authorized investigation or adjudication;

(6) Advise their supervisors of the existence or contemplated development of any record system which retrieves information about individuals by individual identifier;

(7) Maintain an accounting, in the prescribed form, of all dissemination of personal information outside NCUA, whether made orally or in writing;

(8) Disseminate no information concerning individuals outside NCUA except when authorized by 5 U.S.C. 552a or pursuant to a routine use as set forth in the "routine use" section of the "Notice of Systems of Records" published in the *FEDERAL REGISTER*;

(9) Maintain and process information concerning individuals with care in order to ensure that no inadvertent disclosure of the information is made either within or outside NCUA; and

(10) Call to the attention of the proper NCUA authorities any information in a system maintained by NCUA which is not authorized to be maintained under the provisions of the Privacy Act, including information on First Amendment activities, information that is inaccurate, irrelevant or so incomplete as to risk unfairness to the individuals concerned.

(d) Heads of offices within NCUA shall, at least annually, review the record systems subject to their supervision to ensure compliance with the provisions of the Privacy Act.

Part 793

Tort Claims Against The Government

Subpart A—General

§ 793.1 Scope of regulations.

The regulations in this Part shall apply only to claims asserted under the Federal Tort Claims Act, as amended, 28 U.S.C. Sections 2671–2680, accruing on or after January 18, 1967, for money damages against the United States for damage to or loss of property or personal injury or death caused by the negligent or wrongful act or omission of any employee of the National Credit Union Administration while acting within the scope of his office of employment.

Subpart B—Procedures

§ 793.2 Administrative claim; when presented; place of filing.

(a) For purposes of the regulations in this Part, a claim shall be deemed to have been presented when the National Credit Union Administration receives, at a place designated in paragraph (c) of this Section, an executed Standard Form 95 or other written notification of an incident accompanied by a claim for money damages in a sum certain for damage to or loss of property, for personal injury, or for death, alleged to have occurred by reason of the incident. A claim which should have been presented to the National Credit Union Administration but which was mistakenly addressed to or filed with another Federal agency, shall be deemed to be presented to the National Credit Union Administration as of the date that the claim is received by the National Credit Union Administration. A claim mistakenly addressed to or filed with the National Credit Union Administration shall forthwith be transferred to the appropriate Federal agency, if ascertainable, or returned to the claimant.

(b) A claim presented in compliance with paragraph (a) of this Section may be amended by the claimant at any time prior to final action by the Office of General Counsel, National Credit Union Administration or prior to the exercise of the claimant's option to bring suit under 28 U.S.C. 2675(a). Amendments shall be submitted in writing and signed by the claimant or his duly authorized agent or legal representative. Upon the timely filing of an amendment to a pending claim, the National Credit Union Administration shall have 6 months in which to make a final disposition of the claim as amended and the claimant's option under 28 U.S.C. 2675(a) shall not accrue until 6 months after the filing of an amendment.

(c) Forms may be obtained and claims may be filed with the regional office of the National Credit Union Administration having jurisdiction over the employee involved in the accident or incident, or with the Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

§ 793.3 Administrative claim; who may file.

(a) A claim for injury to or loss of property may be presented by the owner of the property interest which is the subject matter of the claim, his duly authorized agent, or his legal representative.

(b) A claim for personal injury may be presented by the injured person, his duly authorized agent, or his legal representative.

(c) A claim based on death may be presented by the executor or administrator of the decedent's estate or by any other person legally entitled to assert such a claim under applicable state law.

(d) A claim for loss wholly compensated by an insurer with the rights of a subrogee may be presented by the insurer. A claim for loss partially compensated by an insurer with the rights of a subrogee may be presented by the insurer or the insured individually, as their respective interests appear, or jointly. Whenever an insurer presents a claim asserting the rights of a subrogee, he shall present with his claim appropriate evidence that he has the rights of a subrogee.

(e) A claim presented by an agent or legal representative shall be presented in the name of the claimant, be signed by the agent or legal representative, show the title or legal capacity of the person signing, and be accompanied by evidence

of his authority to present a claim on behalf of the claimant as agent, executor, administrator, parent, guardian, or other representative.

§ 793.4 Administrative claim; evidence and information to be submitted.

(a) *Death.* In support of a claim based on death, the claimant may be required to submit the following evidence or information:

(1) An authenticated death certificate or other competent evidence showing the cause of death, date of death, and age of the decedent.

(2) Decedent's employment or occupation at the time of death, including his monthly or yearly salary or earnings (if any), and the duration of his last employment or occupation.

(3) Full names, addresses, birthdates, kinship, and marital status of the decedent's survivors, including those survivors who were dependent for support upon the decedent at the time of his death.

(4) Degree of support afforded by the decedent to each survivor dependent upon him for support at the time of his death.

(5) Decedent's general physical and mental condition before death.

(6) Itemized bills for medical and burial expenses incurred by reason of the incident causing death, or itemized receipts of payments for such expenses.

(7) If damages for pain and suffering before death are claimed, a physician's detailed statement specifying the injuries suffered, duration of pain and suffering, any drugs administered for pain and the decedent's physical condition in the interval between injury and death.

(8) Any other evidence or information which may have a bearing on the responsibility of the United States for the death or the damages claimed.

(b) *Personal injury.* In support of a claim based on personal injury, the claimant may be required to submit the following evidence or information: (1) A written report by his attending physician or dentist setting forth the nature and extent of the injury, nature and extent of the treatment, any degree of temporary or permanent disability, the prognosis, period of hospitalization, and any diminished earning capacity. In addition, the claimant may be required to submit to a physical and/or mental examination by a physician employed or designated by the National Credit Union Administration. A copy or report of the examining physician shall be made available to the claimant upon the claimant's written request provided that claimant has, upon request, furnished the report referred to in the first sentence of this subparagraph and has made or agrees to make available to the National Credit Union Administration any other physician's reports previously or thereafter made of the physical or mental condition which is the subject of his claim.

(2) Itemized bills for medical, dental, and hospital expenses incurred, or itemized receipts of payment for such expenses.

(3) If the prognosis reveals the necessity for future treatment, a statement of expected duration of and expenses for such treatment.

(4) If a claim is made for loss of time from employment, a written statement from his employer showing actual time lost from his employment, whether he is a full or part time employee, and wages or salary actually lost.

(5) If a claim is made for loss of income and the claimant is self-employed, documentary evidence showing the amount of earnings actually lost.

(6) Any other evidence or information which may have a bearing on the responsibility of the United States for the personal injury or the damages claimed.

(c) *Property damage.* In support of a claim for damages to or loss of property, real or personal, the claimant may be required to submit the following information or evidence:

(1) Proof of ownership.

(2) A detailed statement of the amount claimed with respect to each item of property.

(3) An itemized receipt of payment for necessary repairs or itemized written estimates of the cost of such repairs.

(4) A statement listing date of purchase, purchase price, market value of the property as of date of damage, and salvage value, where repair is not economical.

(5) Any other evidence or information which may have a bearing on the responsibility of the United States for the injury to or loss of property or the damages claimed.

(d) *Time limit.* All evidence required to be submitted by this Section shall be furnished by the claimant within a reasonable time. Failure of a claimant to furnish evidence necessary for a determination of his claim within 3 months after a request therefor has been mailed to his last known

address may be deemed an abandonment of the claim. The claim may be thereupon disallowed.

§ 793.5 Investigation, examination, and determination of claims.

When a claim is received, the constituent agency out of whose activities the claim arose shall make such investigation as may be necessary or appropriate for a determination of the validity of the claim and thereafter shall forward the claim, together with all pertinent material, and a recommendation based on the merits of the case, with regard to the allowance or disallowance of the claim, to the Office of General Counsel, National Credit Union Administration to whom authority has been delegated to adjust, determine, compromise and settle all claims hereunder.

§ 793.6 Final denial of claim.

(a) Final denial of an administrative claim shall be in writing and sent to the claimant, his attorney, or legal representative by certified or registered mail. The notification of final denial may include a statement of the reasons for the denial and shall include a statement that, if the claimant is dissatisfied with the action of the National Credit Union Administration, he may file suit in an appropriate U.S. District Court not later than 6 months after the date of mailing the notification.

(b) Prior to the commencement of suit and prior to the expiration of the 6-month period after the date of mailing, by certified or registered mail of notice of final denial of the claim as provided in 28 U.S.C. 2401(b), a claimant, his duly authorized agent, or legal representative, may file a written request with the National Credit Union Administration for reconsideration of a final denial of a claim under paragraph (a) of this Section. Upon the timely filing of a request for reconsideration the National Credit Union Administration shall have 6 months from the date of filing in which to make a final disposition of the claim and the claimant's option under 28 U.S.C. 2675(a) to bring suit shall not accrue until 6 months after the filing of a request for reconsideration. Final National Credit Union Administration action on a request for reconsideration shall be effected in accordance with the provisions of paragraph (a) of this Section.

§ 793.7 Payment of approved claims.

(a) Upon allowance of his claim, claimant or his duly authorized agent shall sign the voucher for payment, Standard Form 1145, before payment is made.

(b) When the claimant is represented by an attorney, the voucher for payment (S.F. 1145) shall designate both the claimant and his attorney as "payees." The check shall be delivered to the attorney whose address shall appear on the voucher.

§ 793.8 Release.

Acceptance by the claimant, his agent or legal representative, of any award, compromise or settlement made hereunder, shall be final and conclusive on the claimant, his agent or legal representative and any other person on whose behalf or for whose benefit the claim has been presented, and shall constitute a complete release of any claim against the United States and any employee of the Government whose act or omission gave rise to the claim, by reason of the same subject matter.

§ 793.9 Penalties.

A person who files a false claim or makes a false or fraudulent statement in a claim against the United States may be liable to a fine of not more than $10,000 or to imprisonment of not more than 5 years, or both (18 U.S.C. 287–1001), and, in addition, to a forfeiture of $2,000 and a penalty of double the loss or damage sustained by the United States (31 U.S.C. 231).

§ 793.10 Limitation on National Credit Union Administration's authority.

(a) An award, compromise or settlement of a claim hereunder in excess of $25,000 shall be effected only with the prior written approval of the Attorney General or his designee. For purposes of this paragraph, a principal claim and any derivative or subrogated claim shall be treated as a single claim.

(b) An administrative claim may be adjusted, determined, compromised or settled hereunder only after consultation with the Department of Justice when, in the opinion of the National Credit Union Administration:

(1) A new precedent or a new point of law is involved; or

(2) A question of policy is or may be involved; or

(3) The United States is or may be entitled to indemnity or contribution from a third party and the National Credit Union Administration is unable to adjust the third party claim; or

(4) The compromise of a particular claim, as a practical matter, will or may control the disposition of a related claim in which the amount to be paid may exceed $25,000.

(c) An administrative claim may be adjusted, determined, compromised or settled only after consultation with the Department of Justice when it is learned that the United States or any employee, agent or cost-plus contractor of the United States is involved in litigation based on a claim arising out of the same incident or transaction.

Part 794

Enforcement of Nondiscrimination on the Basis of Handicap in Federally Conducted Programs

This regulation requires the NCUA operate all of its programs and activities to ensure nondiscrimination against qualified handicapped persons. It sets forth standards for what constitutes discrimination on the basis of mental or physical handicap, provides a definition for handicapped person and qualified handicapped person, and establishes a complaint mechanism for resolving allegations of discrimination. This regulation is issued under the authority of Section 504 of the Rehabilitation Act of 1973, as amended, which prohibits discrimination on the basis of handicap in programs or activities conducted by Federal executive agencies.

The regulation will not be reprinted here because of its length and the fact that it is not applicable to credit unions. If a copy is desired, it may be obtained by writing to: Office of the Chief Financial Officer, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

Part 795

OMB Control Numbers Assigned Pursuant to The Paperwork Reduction Act

§ 795.1 OMB control numbers.

(a) *Purpose.* This subpart collects and displays the control numbers assigned to information collection requirements of the NCUA by the Office of Management and Budget (OMB) pursuant to the Paperwork Reduction Act of 1980, Pub. L. 96–511. The NCUA intends to comply with the requirements of section 3507(f) of the Paperwork Reduction Act, which requires that agencies display a current control number assigned by the Director of OMB for each agency information collection requirement.

(b) *Display.*

12 CFR part or section where identified and described	Current OMB control No.
701.1	3133–0015
701.6	3133–0142
701.12	3133–0059
701.13	3133–0059
701.14	3133–0121
701.21	3133–0139
701.22	3133–0141
701.26	3133–0149
701.31	3133–0068
701.32	3133–0114
701.33	3133–0130
701.34	3133–0117
703	3133–0133
704	3133–0129
704.11	3133–0149
705	3133–0137
	3133–0138
708a	3133–0153
708b	3133–0024
711	3133–0152
712	3133–0149
714	3133–0151
723	3133–0101
724	3133–0035
725	3133–0061
	3133–0063
	3133–0064
	3133–0136
	3133–0155
	3133–0156
	3133–0157
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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 709

Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally-Insured Credit Unions in Liquidation

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is issuing a final rule clarifying that as conservator or liquidating agent of a federally-insured credit union, the NCUA Board (Board) will honor a claim for prepayment fees by a Federal Home Loan Bank under the circumstances set forth in the rule.

DATES: The rule is effective September 4, 2001.

FOR FURTHER INFORMATION CONTACT: Chrisanthy J. Loizos, Staff Attorney, Division of Operations, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION: The Board issued an interim final rule addressing a statutory exception to the Board's repudiation powers, when acting as a conservator or liquidating agent, for extensions of credit from a Federal Home Loan Bank to a federally-insured credit union. 66 FR 11229 (Feb. 23, 2001). The final rule is identical to the interim final rule except for one minor technical amendment that corrects an inaccurate statutory citation.

Federally-insured credit unions (FICUs) are eligible for membership at the Federal Home Loan Bank (FHLB) in their district provided they meet certain statutory requirements. 12 U.S.C. 1422(12)(B), 1424. As a member of an FHLB, an FICU may obtain a variety of advances for the purpose of providing funds for housing loans. *See* 12 U.S.C. 1430(a), (j).

The Board, when acting as a conservator or liquidating agent of an FICU, has the discretion to disaffirm or repudiate contracts or leases (i) to which the FICU is a party; (ii) the performance of which the Board determines to be burdensome; and (iii) the disaffirmance or repudiation of which the Board determines will promote the orderly administration of the FICU's affairs. 12 U.S.C. 1787(c)(1). The Federal Credit Union Act establishes an exception to the Board's authority to repudiate contracts entered into by an FICU before the Board is appointed the FICU's conservator or liquidating agent. The Board may not repudiate a contract regarding an extension of credit from any FHLB to an FICU. 12 U.S.C. 1787(c)(13).

The final rule sets forth the circumstances under which the Board, as conservator or liquidating agent, will honor a claim for prepayment fees by an FHLB when an FICU has an outstanding extension of credit with the FHLB. The rule allows the payment of a prepayment fee to an FHLB if set forth in a written contract, provided: (1) That the fee does not exceed the present value of any economic loss suffered by the FHLB; and, (2) the collateral is sufficient to pay in full the principal and interest due on secured advances and the applicable prepayment fee.

The rule tracks one used by the Federal Deposit Insurance Corporation (FDIC) when federally-insured banks with extensions of credit from an FHLB are conserved or placed in receivership. *See* 12 CFR 360.2(e). Like the Board, the FDIC has the statutory authority to repudiate contracts when appointed conservator or receiver for a bank under section 11(e) of the Federal Deposit Insurance Act, but it is prohibited from repudiating extension of credit agreements with FHLBs. 12 U.S.C. 1821(e).

Comments

The comment period ended on April 24, 2000. The Board received eight comments on the interim final rule. One credit union, one national credit union trade group, three state credit union leagues, one corporate credit union, one corporate credit union trade group and an association representing state regulators nationwide submitted comments. Of the commenters who commented on the general merits of the rule, all supported the Board's adoption of the rule. One commenter noted that the statutory provision that prohibits the Board from repudiating terms of a loan agreement with a FHLB is adequate without a rule. Two commenters stated that the rule places credit unions on equal footing with other depository institutions that obtain advances from FHLBs. One commenter specifically mentioned that prior to the rule, certain FICUs could not obtain long-term advances from the FHLB in their district.

Five commenters requested the Board extend the application of the rule to loan advances from corporate credit unions. One expressed concern that the rule shows a preference for FHLBs, but acknowledged that the rule is consistent with the statutory prohibition. This commenter noted that corporate credit unions, like FHLBs, make long-term advances to members and may suffer opportunity or real losses from prepayments. Two commenters asked that the Board recognize the role of corporates, in the credit union movement and as liquidity providers for natural-person credit unions, by honoring their claims for prepayment fees.

The Board may consider the comments regarding extensions of credit by corporate credit unions in another rulemaking. The Board issued § 709.12 as an interim final rule based on having made the requisite findings for issuance of an interim final rule as required by the Administrative Procedure Act. 5 U.S.C. 553. The Board believes an amendment of Part 709 limiting the Board's authority as conservator or liquidating agent to repudiate corporate credit union advances would require an opportunity for public notice and comment.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small entities. For purposes of this analysis, credit unions under $1 million in assets will be considered small entities.

The NCUA Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small entities. This rule allows FICUs that are members of Federal Home Loan Banks to receive advances at lower rates of interest for the benefit of their members without any additional regulatory burden or expense to credit unions. Accordingly, the NCUA has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that this rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C.

551. The Office of Management and Budget has determined that this is not a major rule.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule will apply to some state-chartered credit unions, but it will not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

List of Subjects in 12 CFR Part 709

Credit unions, Liquidations.

By the National Credit Union Administration Board, on July 26, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 721

Federal Credit Union Incidental Powers Activities

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is issuing a final rule that revises a regulation by categorizing activities deemed to be within the incidental powers of a federal credit union (FCU). The final rule also describes how interested parties may request a legal opinion on whether an activity is within an FCU's incidental powers or apply to add new activities or categories to the regulation. The rule also clarifies the conflict of interest provisions applicable to activities authorized by this regulation.

DATES: The rule is effective September 5, 2001.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Senior Staff Attorney, or Chrisanthy J. Loizos, Staff Attorney, Office of General Counsel at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background
B. Overview of Regulation
C. Safety and Soundness Considerations
D. Comments
1. General
2. Other Suggestions
E. Section-by-Section Analysis
F. Regulatory Procedures

A. Background

On November 18, 1999, the NCUA Board (the Board) issued a request for comments in an Advance Notice of Proposed Rulemaking (ANPR) on whether the Board should restructure part 721 of NCUA's regulations and adopt provisions regarding incidental powers within the regulation. 64 FR 66413 (November 26, 1999). At the time, the Board envisioned that it would create four sections within part 721 and expand its test for analyzing the incidental powers of FCUs. After receiving the public's comments on the ANPR, the Board issued a Notice of Proposed Rulemaking on November 16, 2000. 65 FR 70526 (November 24, 2000).

In the proposed rule, the Board restructured part 721 into seven sections. The proposed rule established a definition for an incidental powers activity by using a three-prong test. The proposed rule also set out categories determined to be within an FCU's incidental powers. A majority of the proposed categories are activities NCUA has previously established as within the incidental powers of FCUs in legal opinions. The proposed rule identified the following twelve categories: Certification services, correspondent services, electronic financial services, excess capacity, financial counseling services, finder activities, marketing activities, monetary instrument services, operational programs, stored value products, and trustee or custodial services. Each category in the proposed rule contained examples of incidental powers activities.

The proposed rule provided that FCUs could seek advisory opinions from NCUA's General Counsel as to whether a proposed activity fits into one of the authorized categories or is otherwise an incidental powers activity. It also established a process for FCUs to petition NCUA to approve new activities or categories of activities. The proposed rule also allowed FCUs to receive compensation from any activity determined to be within their incidental powers. Finally, the proposed rule amended the conflicts of interest provision in part 721, to conform to similar conflict provisions in NCUA's regulations.

B. Overview of Regulation

Incidental Powers Authority

The legal authority for the expanded activities authorized by the final rule is the incidental powers provision of the Federal Credit Union Act (FCU Act), 12 U.S.C. 1757(17). The FCU Act expressly grants FCUs the power to, among other activities, purchase, hold and dispose of property; make loans to members; make certain investments; accept share, share draft and share certificate accounts; and sell and cash negotiable instruments. 12 U.S.C. 1757(4)–(7), (12), (15). The accompanying incidental powers provision states that an FCU may ''exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated.'' 12 U.S.C. 1757(17).

1. *Arnold Tours Standard.* To determine whether an activity is authorized under the incidental powers provision, NCUA has looked to whether the activity is convenient or useful in connection with the performance of an FCU's established activities pursuant to its express powers granted by the FCU Act. This standard was established in *Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427 (1st Cir. 1972), for determining the incidental powers of national banks. *Accord Independent Insurance Agents of America, Inc.* v. *Hawke,* 211 F. 3d 638, 640 (D.C. Cir. 2000) (''Whether a particular banking device's nomenclature harkens to traditional banking activities is not dispositive''); *First National Bank of Eastern Arkansas* v. *Taylor,* 907 F.2d 775, 778 (8th Cir.), *cert. denied,* 498 U.S. 972 (1990) (''Incidental powers are not confined to activities considered essential to the exercise of express powers''); *M&M Leasing Corp.* v. *Seattle First National Bank,* 563F.2d 1377, 1382 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978) (''powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking''). In addition, *Arnold Tours* recognized certain ''agency or informational services'' that, although not necessarily rooted in an incidental power, represent a permissible ''goodwill'' service to customers when provided on a limited and largely uncompensated basis. 472 F.2d at 432.

The convenient or useful standard adopted in *Arnold Tours* has been acknowledged as proper for analyzing the incidental powers provision of the FCU Act. *American Bankers Association* v. *Connell,* 447 F. Supp. 296, 298 (D.D.C. 1978), *rev'd,* 595 F.2d 887 (D.C. Cir.), *cert. denied,* 444 U.S. 920 (1979). Relaxing that standard, a subsequent court pronounced it ''narrow and artificially rigid,'' preferring instead to focus on the ''essence'' of the service being provided and its functional equivalency to a permitted activity. *American Insurance Association* v. *Clarke,* 865 F.2d 278, 281, 284 (D.C. Cir. 1988).

For many years, NCUA has followed the reasoning of *Arnold Tours* in recognizing various activities either as incidental to an FCU's exercise of its express powers or simply as a permissible ''goodwill'' service to members. Upon a finding that an activity is either convenient or useful in connection with performance of an expressly granted power, NCUA has authorized FCUs to engage in a broad range of activities, including the authority to: Engage in marketing and promotional activities on behalf of the FCU, provide a variety of loan-related products, perform various payment and money exchange functions for members, make charitable donations and contributions, provide correspondent services, engage in consumer leasing, establish numerous products and services derived from share accounts, and perform various financial functions to assist member business transactions.

In addition, NCUA has allowed FCUs to implement new operational programs so that FCUs and their members benefit from technological advancements in the financial services industry, such as: Electronic fund transfers, automated teller machines, payroll deduction and direct deposit services, debit cards, and wire transfer services. Further, NCUA has permitted various activities as informational or goodwill services for members, including promoting the products and services of third parties and permitting FCU endorsement, on a cost reimbursement basis. 50 FR 16462, 16463 (April 26, 1985) (final rule addressing insurance and group purchasing activities).

As shown in the Section-by-Section Analysis below, much of the final rule simply codifies the practices NCUA has approved through legal opinions over the years as incidental powers under *Arnold Tours.* Further relying on *Arnold Tours,* the final rule introduces a number of activities that, as explained below, similarly qualify as incidental powers because they are ''convenient or useful'' in performing an activity established under an express power.

2. *VALIC Standard.* The U.S. Supreme Court has broadened the standard for considering an expansion of the incidental powers of national banks. In *Nationsbank of North Carolina* v. *Variable Annuity Life Insurance Co. (VALIC),* 513 U.S. 251 (1995), the Court stated that the authorization of ''incidental powers * * * necessary to carry on the business of banking'' is an independent grant of authority, *id.* at 258, separate from the five activities specifically enumerated in the National Banking Act, 12 U.S.C 24(Seventh). *Accord Independent Insurance Agents,* 211 F. 3d at 640 (''enumeration of powers is only illustrative and Comptroller may authorize additional activities if encompassed by a reasonable interpretation''); *Norwest Bank Minnesota, N.A.* v. *Sween Corp.,* 118 F.3d 1255, 1259 (8th Cir. 1997) (analyzing whether activity is closely related to an express power and useful in carrying out business of banks). The Court rejected the argument that the powers of national banks are limited to the five specifically enumerated activities, regarding those activities as ''exemplary, not exclusive.'' 513U.S. at 258. The Court held that ''the 'business of banking' is not limited to the enumerated powers in section 24 (Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated,'' provided that discretion is ''kept within reasonable bounds.'' *Id.* at 259 n.2.

Applying the reasoning of *VALIC* to sec. 1757, ''the business for which [a credit union] is incorporated'' is not limited to the express powers in that section. Rather than linking incidental powers to express powers, *VALIC* has provided the framework for the Board to adopt a broader and more flexible analysis, giving it discretion to authorize FCUs to engage in activities beyond those specifically enumerated in sec. 1757. Thus, activities may fall within an FCU's incidental powers if they qualify as either ''convenient or useful'' in connection with an express power or otherwise fall within the scope of ''the business for which [a credit union] is incorporated.''

NCUA has relied on the *VALIC* analysis in recent opinions. For example, a 1999 Office of General Counsel legal opinion authorized FCUs to maintain foreign currency accounts to facilitate member transactions. NCUA reasoned that, by maintaining a foreign bank account to facilitate member transactions, an FCU can: (1) Provide basic credit union services such as lending and deposit taking to members who, due to their residence in a foreign country, are unable to obtain these services from the FCU's domestic offices; and (2) benefit members by providing these services conveniently and at minimal cost in comparison to currency conversion expenses. A deposit account in a foreign bank, which is established for foreign currency exchanges and to facilitate basic services for members located in foreign countries, is closely related to an FCU's deposit taking and lending authority and is useful in carrying out the business of credit unions.

As Congress reiterated most recently in 1998, the FCU Act defines the business for which credit unions are incorporated—to promote thrift among members and to create sources of credit for provident or productive purposes. 12 U.S.C. 1752(1); Public Law No. 105–219, 112 Stat. 913, § 2 (1998). ''Thrift'' refers to ''wise economy in the management of money and other resources.'' *American Heritage Dictionary of the English Language* (4th ed. 2000) at 1802. A purpose is ''provident'' if it anticipates ''providing for future needs or events,'' *id.* at 1411; it is ''productive'' if it involves ''the creation of goods or services to produce wealth or value.'' *Id.* at 1399. NCUA has consistently construed the authority of FCUs broadly to afford them maximum flexibility in providing services to their members. 50 FR 16462, 16463 (April 26, 1985). In this instance, Congress's record of steadily expanding the range of expressly granted powers, combined with the legislative history encouraging NCUA to meet the needs of FCUs and their members, justify, if not require, a broad and ambulatory view of the business for which FCUs are incorporated.

A congressional priority in enacting the FCU Act in 1934 was to ''ensure that [credit unions] would remain responsive to members'' needs.'' *First National Bank & Trust Co.* v. *NCUA,* 988 F.2d 1272,1274 (D.C. Cir. 1993). To that end, Congress has since amended the FCU Act, steadily expanding the powers of FCUs, to ensure that they keep pace with changes and developments in the financial services marketplace. The power to make loans was expanded seven times between 1949 and 1987. 12 U.S.C. 1757(5). These amendments included: Raising the maximum maturities limits; extending the range of permissible loan types and purposes, such as loans to credit union service organizations (CUSOs) and participation loans; and even abandoning the limitation that loans be made for ''provident and productive purposes.'' The power to receive payments on shares, sec. 1757(6), was expanded five times between 1970 and 1980 and included amendments permitting FCUs to offer share certificates and share draft accounts, to accept certain types of nonmember deposits, and to receive payments on shares from the Central Liquidity Facility. The power to invest funds, sec. 1757(7) and (15), has been expanded nine times between 1937 and 1984, extending the list of permissible government guaranteed obligations and entities and allowing FCUs to invest in CUSOs, secondary market instruments, and mortgage-backed securities. The express power to sell and cash checks and money orders for a fee was added in 1959, and, in 1982, it was extended to ''similar money transfer instruments,'' allowing FCUs to charge a fee in excess of direct costs. 12 U.S.C. 1757(12).

In the course of expanding the powers of FCUs, Congress has repeatedly taken the opportunity to encourage NCUA to be flexible, innovative and responsive in meeting the needs of FCUs and their members. When Congress created NCUA in 1970, the same year that share insurance was introduced, it recognized that ''credit unions have become such a significant component of our society that they need and deserve a more responsive and independent regulatory agency.'' S. Rep. 91–518 at 2 (1970), *reprinted in* 1970 U.S.C.C.A.N. 2479, 2480. Further, Congress envisioned that NCUA would have ''a great responsibility and an opportunity to

make real and substantial contributions to our society,'' and ''would be able to be more responsive to the needs of credit unions and to provide more flexible and innovative regulation.'' *Id.* at 2481.

When Congress amended the FCU Act in 1977 to add an extensive array of savings, lending and investment powers, it intended to ''allow credit unions to continue to attract and retain the savings of their members by providing essential and contemporary services,'' and acknowledged that credit unions are entitled to ''updated and more flexible authority granting them the opportunity to better serve their members in a highly-competitive and ever-changing financial environment.'' H.R. Rep. 95–23 at 7 (1977), *reprinted in* 1977 U.S.C.C.A.N. 105, 110. Congress acknowledged the difficulty in ''regulating contemporary financial institutions within the framework of an Act that has on a continuing basis required major updating by means of regulation.'' *Id.*

When Congress enacted the Garn-St. Germain Depository Institutions Act in 1982, which among other things, extended FCU real estate lending and investment powers, it noted that credit unions ''continue to face increasing competition from both within and outside of the financial system * * * as they prepare themselves for a future certain to contain a more rapidly changing financial marketplace than ever previously expected.'' S. Rep. No. 97–356 at 34 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3054, 3088. The purpose of the legislation, said Congress, is ''to help credit unions meet the challenges of today's rapidly changing and fiercely competitive financial market and to enhance NCUA's ability to more fairly and effectively carry out its responsibilities.'' *Id.* at 3089.

Following the example and encouragement of Congress to be flexible, innovative and responsive, the Board recognizes that the business of promoting thrift and providing access to credit for provident and productive purposes has witnessed a dramatic shift from the Depression-era economy of 1934, to a post-War, industrial boom economy, to the present information age economy. During this evolution, financial services and products have emerged and matured. Advances in technology and communications have improved, and will continue to improve, the delivery of financial services. The marketplace for financial services has expanded and diversified, and competition has intensified. It is, therefore, a reasonable exercise of discretion for the Board to expand the range of incidental powers accordingly to fit the contemporary business of credit unions. This will equip FCUs to deliver products and services that facilitate the modern day practice of thrift and the provident and productive use of credit.

For these reasons, the final rule authorizes as incidental powers under sec. 1757(17) certain activities that, even if not linked to an expressly granted power, nonetheless are convenient or useful in carrying out ''the business for which [credit unions] are incorporated,'' as that business has evolved since 1934; are a functional equivalent or logical outgrowth of activities within that business; and involve risks similar in nature to those already assumed as part of that business.

C. Safety and Soundness Considerations

The Board wants to emphasize that, while the final rule identifies categories of activities the Board has identified as within an FCU's incidental powers under the FCU Act, an FCU must comply with all applicable legal requirements and give due consideration to safety and soundness concerns before engaging in an incidental powers activity.[1] To carry out its responsibilities, FCU management must consider whether its policies for new activities are realistic and carefully designed to enable the FCU to serve the interests and needs of the membership. In addition to meeting various legal requirements, many incidental powers activities require management to provide direction and instruction for officers, employees, and committees delegated the responsibility for implementing new activities and services.

FCU management is responsible for developing proper internal safeguards such as management oversight, internal controls and quality control. FCUs must examine the strategic risk, reputation risk, transaction risk and compliance risk before engaging in a new activity. In addition, management must exercise due diligence before devoting resources to a new activity or entering into any arrangements with third parties. Activities that involve the use of new technologies must rely on acceptable information systems and operations architecture. FCUs capable of providing advanced technological services must employ appropriate internal controls to minimize technological and legal risk and to address safety and soundness considerations. FCUs must also adjust their risk management process and insurance coverage to correlate with additional risk taken on by engaging in new activities.

NCUA has published guidance papers to assist FCUs in evaluating the risks and understanding the legal requirements involved in some of these activities. This guidance includes: (1) NCUA Letter to Credit Unions No. 01–CU–02 (February 2001), offering guidance on the privacy of consumer financial information; (2) NCUA Letter to Credit Unions No. 109 (September 1, 1989), discussing risks associated with certain computer operations; (3) NCUA Letter to Credit Unions No. 97–CU–5, addressing electronic financial services, (4) NCUA Letter to Credit Unions No. 00–CU–11, regarding risk management of outsourced technology services, and (5) NCUA Interpretive Ruling and Policy Statement 85–1, covering trustees and custodians of pension plans. NCUA's published guidance, along with NCUA's regulations, are available from the agency's website at *www.ncua.gov*. The Board also recommends that FCUs review interpretive letters and guidance issued by other federal financial institution regulators for assistance in understanding an activity's risks, for example, OCC Bulletin 2001–12 on bank-provided account aggregation services and OCC Advisory Letter 2000–9 on third-party risk. Depending on the activities an FCU undertakes, it may also need to consult with its own legal counsel and other professional advisers.

D. Comments

1. General

In response to the proposed rule, the Board received comments on the following issues: the appropriateness of its incidental powers test, the proposed categories, suggested additions for the proposed rule, the application process for expanding the categories, the compensation provision, and the conflict of interest prohibitions. Although the Board actually received over three hundred comment letters or e-mail messages, NCUA staff has

[1] In addition to the FCU Act and NCUA's regulations, FCUs are subject to numerous other laws and regulations, including: Truth in Savings Act, Truth in Lending Act and Regulation Z, Equal Credit Opportunity Act and Regulation B, Electronic Funds Transfer Act and Regulation E, Preservation of Consumer's Claims and Defenses Rule, Fair Credit Reporting Act, Real Estate Settlement Procedures Act and Regulation X, Fair Debt Collection Practices Act, Home Mortgage Disclosure Act and Regulation C, Currency and Foreign Transactions Act, Flood Disaster Protection Act, Right to Financial Privacy Act, Soldier's and Sailor's Civil Relief Act, Fair Housing Act, Government Securities Act of 1986, Regulation G, Expedited Funds Availability Act and Regulation CC. FCUs are also subject to various state laws, such as commercial codes, abandoned property laws, and privacy laws.

credited multiple comment letters from the same credit union as one comment, for a total of two hundred and seventy-two comment letters.

Two hundred and sixty commenters supported the proposed rule or expanding the incidental powers of FCUs in some manner. These commenters commended the Board for its review of the incidental powers of FCUs. Generally, the commenters noted that the proposal gives FCUs the ability to respond to growing member needs. A majority of these commenters supported the proposed rule because it removes regulatory uncertainty, allows FCUs to offer more services, provides income opportunities and allows FCUs to compete with other financial service providers. Several commenters noted that the regulation allows smaller credit unions that cannot afford to invest in credit union service organizations to offer expanded services to their members.

Three banking trade groups and two credit unions opposed the proposed regulation. Two banking trade groups requested that the proposed rule be withdrawn, arguing that NCUA lacks authority to interpret incidental powers in the manner proposed. These commenters stated that the incidental powers of FCUs must be incidental to the promotion of thrift or creating a source of credit. One commenter stated that FCU incidental powers must be directly tied to an expressly authorized activity. Another stated that FCUs have a limited mission in exchange for tax-exempt status. Two credit unions generally opposed the rule because it expands income generating opportunities.

2. Other Suggestions

NCUA received many comment letters from state-chartered credit unions fully supporting adoption of the proposed rule. Several of these commenters stated they will benefit from the expansion of FCU incidental powers because their state laws give state-chartered credit unions parity with FCUs operating in their states. Thirteen commenters asked for a ''wildcard'' or parity provision for FCUs whereby an FCU could engage in the same activities permitted for state-charters in the state in which the FCU is located. The FCU Act does not contemplate a parity provision as suggested by the commenters. In determining whether an FCU may engage in an activity under its incidental powers, an analysis under the FCU Act is required.

Four commenters asked that the rule also permit FCUs to engage in all of the activities permitted for CUSOs. The Board acknowledges that the final rule permits FCUs to engage in some activities traditionally performed by CUSOs. For example, both FCUs and CUSOs may offer income tax preparation. The authority of FCUs and CUSOs, however, is interpreted under separate provisions of the FCU Act. A CUSO is ''any organization as determined by the Board, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.'' 12 U.S.C. 1757(5)(D). Based on this statutory definition of a CUSO, the Board establishes the parameters for CUSOs in part 712. TheBoard evaluates the incidental powers of FCUs, however, based strictly on its interpretation of sec. 1757(17).

The Board presented the proposed rule in a plain English, question-and-answer format. Only two commenters disapproved of the question-and-answer format, stating it makes the rule awkward to read and difficult to understand and suggesting it is suitable only for appendices. The goal of plain language drafting is to minimize confusion, inadvertent errors and the amount of time interested parties must devote to understanding the rule. The Board believes, for many regulations including this one, it promotes regulatory comprehension, compliance and administrative efficiency.

E. Section-by-Section Analysis

Section 721.1 What Does This Part Cover?

This section describes the scope of part 721. The final rule covers the incidental powers of federally-chartered, natural-person credit unions under 12 U.S.C. 1757(17).

Two commenters asked if the rule allows FCUs to provide expanded services to member business accounts or restricts these new powers to services for natural person members. An FCU may provide the activities and services authorized under part 721 to all of its members.

Several commenters raised questions about the application of part 721 to corporate credit unions. The Board generally interprets the powers of corporate credit unions in part 704 and does not intend part 721 to apply to corporate credit unions.

Section 721.2 What is an Incidental Powers Activity?

Following the reasoning of *VALIC* discussed in section C.1. *supra*, the Board believes that it is no longer necessary to link an incidental power directly to an express power granted in the FCU Act. Instead, an activity may generally be considered to fall within an FCU's incidental powers if it is ''necessary or requisite to enable it to carry on effectively the business for which it is incorporated.'' 12 U.S.C. 1757(17). For the reasons discussed above, the Board believes that the business of FCUs is to provide financial services to their members that, as contemplated by the FCU Act, facilitate the practice of thrift and the provident and productive use of credit.

Reflecting this view, the final rule retains the three-prong test, set forth in the proposed rule, to determine whether an activity is authorized as an appropriate exercise of an FCU's incidental powers: (1) Whether the activity is convenient or useful in carrying out the mission or business of credit unions consistent with the FCU Act; (2) whether the activity is the functional equivalent or logical outgrowth of activities that are part of the mission or business of credit unions; and (3) whether the activity involves risks similar in nature to those already assumed as part of the business of credit unions. An activity must meet all three criteria to qualify as an incidental power. The criteria are substantially similar to those used by the Office of the Comptroller of the Currency (OCC); however, for purposes of identifying the incidental powers of FCUs, they will be applied so as to take into account the distinctive features and functions of credit unions in the context of the business for which they are incorporated, as that business has evolved since 1934. Thus, while the Board may look to other laws and precedents in the financial services industry for guidance in applying these criteria, its analysis may produce a different result than in the case of other types of financial institutions.

Seventy-six commenters specifically supported the proposed three-prong test. Many of these commenters asked that the Board read the test broadly. Several of the commenters noted the similarity between the proposed criteria and the standard used by the OCC when authorizing activities for banks. These commenters found the test appropriate when considering the similarity of financial services offered by credit unions and other financial service providers.

One commenter suggested that, when NCUA analyzes the business of credit unions, it should defer to the marketplace as experienced by credit unions and their members. One commenter advocated changing the first prong of the test to replace the business

of credit unions with an analysis of whether the activity is convenient and useful in meeting the economic and social well-being of members consistent with the FCU Act. Four other commenters suggested amending the third prong of the test. One recommended that NCUA look at whether the risks involved in a proposed activity exceed those already assumed as part of the business of credit unions. Another stated that the third prong of the test should require NCUA to analyze the way an FCU manages the risk associated with the proposed activity through a cost/benefit analysis. The Board believes that, after evaluating *Arnold Tours, VALIC* and the opinions of the OCC, the three-prong test adopted in the final rule is an appropriate method for determining whether an activity is a permissible exercise of an FCU's incidental powers.

Section 721.3 What Categories of Activities Are Preapproved as Incidental Powers Necessary or Requisite To Carry on a Credit Union's Business?

Section 721.3 establishes categories of activities the Board has determined to be within an FCU's incidental powers. The final rule also provides a mechanism for approving additional activities in § 721.04.

Eighty commenters supported including categories of approved activities as examples of incidental powers activities within the rule. Those commenters supporting a list generally approved of the identified categories and asked that the activities named within each category remain illustrative of permitted activities and not exclusive. One commenter suggested the rule clarify that FCUs have the authority to determine whether a proposed activity, not specifically given as an example in the rule, fits into one of the preapproved categories. Another commenter asked that the rule state that an activity is permitted unless it is expressly prohibited.

An FCU may only engage in activities that are either expressly authorized by statute or within the FCU's incidental powers. The final rule permits FCUs to analyze for themselves whether a particular activity, not provided as an example in one of the broad categories, falls into one of the preapproved categories. The analysis an FCU should follow in determining whether an activity is permissible is discussed below in the section-by-section analysis of § 721.4.

One commenter recommended that the rule require NCUA to review the list of categories biannually to determine if the agency should add new categories to the list, while two others asked for a periodic or annual review of the categories. The Board believes a periodic review requirement in the rule, itself, is unnecessary. The final rule establishes a procedure for FCUs to request amendments when they have identified activities that they contend are necessary or requisite to carry on their business. In addition, NCUA has a process for periodically updating, clarifying and simplifying all existing regulations. NCUA Interpretive Ruling and Policy Statement Number 87–2 (September 1987), 52 FR 35231 (September 18, 1987).

Ten commenters opposed using a list of categories within the regulation, stating that the use of list, although drafted with the intent of being illustrative, may be construed as precedent or exclusive over time. These commenters suggested that, instead of a list, NCUA should place the categories in a commentary or appendix to the regulation as examples of permitted activities. Forty-nine commenters disapproved of the use of categories in the rule and recommended that NCUA allow FCUs to determine on their own whether an activity is within their incidental powers. These commenters stated that the list of categories is restrictive and will become outdated. They also stated the process for expanding the list is cumbersome and time-consuming. Many suggested that the Board set a clear standard so that FCUs could determine their own incidental powers.

As discussed further below in connection with § 721.4, the final rule provides for regulatory approval to identify additional incidental powers activities, recognizing the deference to which the NCUA as regulator is entitled in making this determination. The Board believes that regulatory identification of permissible activities, provided in the rule's list of categories or as approved through an application process, provides assurance to FCUs that the activities in which they engage are legal.

Some of the commenters asked that NCUA expand the list of categories identified; however, they did not suggest particular activities or categories. Several commenters specifically requested that NCUA add particular categories or additional activities within the existing categories. These comments are reflected below in the discussion of each category.

Certification Services

The Board has identified various certification services, such as notary services, electronic signature authentications and signature guarantees, as within the incidental powers of an FCU.

The provision of notary services has been an exercise of an FCU's incidental powers for many years. A notary administers oaths, verifies the identity of a signer, attests to the verification, records signatures, and authenticates commercial transactions. By providing notary services to members, an FCU facilitates transactions for its members that require the certification of signatures. This service allows for timely processing of credit union transactions as compared with sending members elsewhere for notarizations. Therefore, this service is convenient and useful in carrying out an FCU's business by allowing it to operate efficiently and effectively.

Similarly, the Board has determined that the authentication of electronic signatures is analogous to notarization. Like a notary, a certification authority (CA) verifies the identity of the signer and authenticates the signature or electronic equivalent in accordance with contractually agreed upon standards. Like the OCC, the Board finds that the CA activity is the functional equivalent of notary and other authentication services provided by credit unions, and a logical outgrowth of identification and verification methods. *See* OCC Conditional Approval No. 267 (January 1998). The risks borne by an FCU acting as a CA are similar to a notary's risk of improper verification and are similar to those risks inherent in providing electronic services.

FCUs, as eligible guarantor institutions, are permitted to issue signature guarantees for the transfer of securities. 17 CFR 240.17Ad-15. A signature guarantor warrants the authority of the signer as well as the genuineness of the signature. FCUs may offer signature guarantees for stock transfers and U.S. Treasury transactions, as provided by law, under their incidental powers because this type of identity verification is the functional equivalent or logical outgrowth to the provision of notarial services. Like notary services, this activity conveniently facilitates members' financial transactions. The final rule also includes share draft certifications as an example of a permissible certification service. NCUA's longstanding position has been that the certification of share drafts is convenient and useful to an FCU in carrying out its express authority to offer share draft accounts to its members.

Correspondent Services

Correspondent services have been an exercise of an FCU's incidental powers for many years. Correspondent services are services or functions provided by an FCU to another credit union that the FCU is authorized to perform for its own members or as part of its operation. Parties to a correspondent credit union arrangement must establish a written agreement addressing the credit unions' responsibilities under the service arrangement. Correspondent services may include receiving share and loan payments, disbursing share withdrawals and loan proceeds, cashing share drafts, cashing and selling money orders, processing loans, and performing other back office operations or member services for another credit union. An FCU, however, cannot be in the business of managing other credit unions. One commenter suggested that the category of correspondent services include loan servicing, escrow services and internal audits. The Board agrees that these are additional examples of correspondent services and has added them to the rule.

A correspondent service is offered in the same manner it is performed within the FCU's operation and entails the same risks as those assumed by the FCU for its operation. Correspondent service agreements enable credit unions to extend a greater array of services to their members. This activity is convenient and useful to a recipient of a correspondent service in carrying out many of its express powers when the credit union may have difficulty in performing the service on its own. Often, correspondent service programs are implemented when distance prevents members' ready access to their own credit union's place of business. Correspondent relationships also allow credit unions to assist other credit unions that lack resources or expertise.

One commenter noted that the proposed rule and preamble did not address the interplay of the proposed rule with 12 CFR 701.26, Credit Union Service Contracts. This commenter stated that the proposed rule either conflicts with § 701.26 or works to negate it. The Board wishes to clarify any perceived inconsistencies on this issue. The rule governing credit union service contracts covers contracts between FCUs and third party vendors or other organizations for assets or services related to an FCU's daily operations. It also allows an FCU to represent another credit union in contractual arrangements with vendors, but § 701.26 does not give FCUs the authority to provide services, like data processing, directly to other credit unions. 54 FR 48110 (November 21, 1989). FCUs are authorized to provide their services directly to other credit unions under various express powers and the incidental powers clause of the FCU Act, as discussed above. Therefore, the Board does not believe that a conflict exists between the correspondent services permitted under the final rule and § 701.26 because these rules govern two different types of activities.

Electronic Financial Services

The final rule provides that FCUs may offer, through electronic means and facilities, any activity, function, product or service they are otherwise authorized to provide under their express or incidental powers. FCUs may establish their own web sites to promote credit union services and effect member transactions, such as electronic bill payment, bill presentment, account aggregation, account inquiries and transfers. Web sites have become the electronic equivalent of newsletters, office signs and teller services. They provide a convenient and useful means for FCUs to carry out their business.

Through a transactional web site, an FCU may advertise and communicate with its members and others within its field of membership. Features, such as electronic bill payment and bill presentment, allow members to schedule payments and complete transactions without handwritten drafts or visits to a brick and mortar facility. As noted by the OCC, the risks confronted in providing financial services over the Internet are similar to the risks associated with the permissible activities of providing these services via electronic means generally. OCC Interpretive Letter No. 742 (August 1996).

As part of the electronic delivery of traditional products or services, the Board believes FCUs have the authority under their incidental powers to engage in new activities or services due to the changing commercial environment, such as Internet access. By providing Internet access services to its members, an FCU offers its members a device to receive electronic products and services from the FCU. It also assures the FCU that members will access the FCU's home page when they initially connect to the Internet, positioning the FCU to market its products successfully. Members using the FCU's Internet access and transactional web site can retrieve account information and process transactions just as they would through tellers, automated teller machines or telephone response systems.

Similarly, account aggregation services over the Internet enable FCUs to serve as their members' primary financial institution. In providing this service, an FCU may gather a member's publicly available and personal account information from a variety of sources on the Web, allowing convenient access to the member's information. Members grant FCUs access to their information because they view their FCU as a trusted financial intermediary. Account aggregation services are convenient and useful to an FCU's offering of loans, share drafts and share certificates, all expressly granted powers. With access to their consolidated financial portfolio, members have the opportunity to evaluate and compare similar products sold by the FCU. The FCU may also offer members the ability to initiate transactions or obtain financial advice as a result of this service.

One commenter suggested that the electronic financial services category include automated teller machines. Four commenters suggested that the rule place account aggregation services within the category of electronic services. The Board agrees with both of these suggestions and has included these services as examples in the rule.

Excess Capacity

The Board recognizes that, in planning for future expansion and offering new products and services to their members, FCUs should be able to sell their excess capacity as a matter of good business practice. The sale of excess capacity offers FCUs the opportunity to provide financial services to its members, even though member demand for the services does not initially meet the FCU's capacity. The opportunity to sell excess capacity may involve leasing excess office space, sharing employees, or using data processing systems to process information for third parties. As the business of FCUs is to provide financial services to their members, the Board believes that the sale of excess capacity is within an FCU's incidental powers under two conditions: (1) The FCU properly established the service or made the investment with the good faith intent of serving its members; and (2) the FCU reasonably anticipates that the excess capacity will be taken up by the future expansion of services to its members.

Two commenters suggested that NCUA allow low-income credit unions and credit unions serving the underserved to build or acquire real property without a plan for the FCU's

future use in order to facilitate the services to others within the low-income community. The Board does not find legal justification for establishing a different analysis of the incidental powers of FCUs that relies on the field of membership of an FCU. FCUs, including low-income credit unions and credit unions serving the underserved, may sell a service or the use of an asset in excess of the FCU's needs only under the conditions identified in this rule.

Four commenters asked for a liberalization of the concept of excess capacity. These commenters stated that an FCU should not need to anticipate that its members will eventually use any excess capacity; they should be allowed simply to take advantage of economies of scale that result from, for example, processing larger volumes of daily transactions or purchasing technology. The Board does not agree with these commenters. NCUA has consistently held the position that an FCU has limited authority in the leasing of fixed assets and the sale of excess data processing capacity. FCUs are not in the business of providing others with data processing capacity or any other service that is not within their express or incidental powers; rather, they are cooperative financial institutions organized to provide financial services to their members.

Another commenter stated that the regulatory text does not include the two-prong analysis for excess capacity as discussed in the proposed rule's preamble. The absence of this language, the commenter stated, allows for an interpretation that is broader than suggested by the preamble's discussion. The Board agrees that clarification of the definition of excess capacity is necessary and has inserted the excess capacity analysis into the final rule.

Financial Counseling Services

The Board believes that, as part of providing credit and saving opportunities for their members, FCUs have the responsibility of promoting provident planning through consumer education and responsible investment. Educating and counseling members in financial matters is convenient and useful to an FCU in exercising its express powers of lending and receiving shares. Members who are well-informed and educated in financial matters tend to be prudent and responsible when obtaining financial products and repaying debt, which in turn reduces losses at an FCU. The Board believes it is part of the business of FCUs to provide financial counseling services to their members including estate planning, income tax preparation and filing, and investment and retirement counseling. One commenter recommended that this category include debt and budget counseling. The Board has added this example to the final rule.

One commenter supported the ability of FCUs to offer financial counseling, but asked NCUA to provide guidance regarding registration requirements and cross-jurisdictional issues that may arise between NCUA and other regulators, such as the Securities and Exchange Commission. As discussed further in the analysis of § 721.5, the final rule identifies activities that are within the incidental powers of FCUs, but an FCU must still comply with other legal requirements pertaining to an identified activity. Depending on the particular activity, an FCU may be subject to other federal, state or local law. Some of these legal requirements may be extensive and it would be impossible to incorporate them completely within this rule. Just as an FCU is responsible for making its own determination regarding the safety and soundness of a particular activity, it is incumbent on an FCU to apprise itself of any legal requirements associated with the activity.

Two commenters asked that the final rule permit financial planning under the category of financial counseling. Five commenters suggested that the final rule include brokerage services in a category, such as financial counseling. One commenter supported the proposed rule's description of financial counseling but believed that the proposed rule conflicted with NCUA Letter to Credit Unions No. 150 (Letter 150), which governs sales of nondeposit investment products through third parties. This commenter asked that NCUA discuss the interplay between Letter 150 and this category.

The final rule defines financial counseling services as advice, guidance or services that an FCU offers to its members to promote thrift or to otherwise assist members in financial matters. Under this activity, FCUs may counsel members about financial matters, such as setting budgets, establishing financial goals, and managing tax liabilities. Other examples within this category may include counseling members on money management, paying down debt, saving for the future, types of investments, and diversification principles. This category applies only to financial counseling provided by an FCU to its members and does not encompass activities that require SEC registration as a broker, dealer or investment adviser.

Letter 150 provides guidance for third party sales of securities to FCU members, a finder activity. Third party sales of securities entail an FCU introducing its members to vendors who engage in the sale of nondeposit investment products. This differs from an FCU directly providing financial counseling, as defined above, to its members. Therefore, as a result of the final rule, Letter 150 remains unchanged with the exception of the Letter's paragraph f. Paragraph f of Letter 150 limits reimbursement to an FCU from a third party vendor at the total direct and indirect costs of any administrative functions the FCU performed for the vendor. As addressed in detail in the following category and in the discussion regarding § 721.6, the final rule removes compensation restrictions on finder activities as contemplated in Letter 150. FCUs, should note however, that they may be subject to other regulatory restrictions regarding commissions or fees paid to an FCU in conjunction with the sale of mutual funds or nondeposit investment products.

Finder Activities

The final rule allows FCUs to engage in finder activities through their role as financial service providers and intermediaries of financial services. The rule authorizes an FCU to introduce or otherwise bring together outside vendors with its members for the negotiation and consummation of transactions. Another fundamental aspect to finder activities is providing information to members about the products or services of third parties.

The Board believes that finder activities are member services that are necessary or requisite to enable FCUs to carry on their business effectively. FCUs can serve as their members' primary financial institution by bringing members together with providers of services and products. Although the FCU does not act as a broker, the FCU may negotiate group discounts or benefits on behalf of its membership with vendors. Additionally, these referrals enhance the quality of service FCUs offer their members and afford the FCU the opportunity to promote its own products as well. Examples of finder activities include placing third party vendor advertisements in the FCU's account statements, newsletters or as a link to the vendor's web site on the FCU's home page.

One commenter requested that NCUA offer guidance that distinguishes finder activities from marketing activities. Under the category of finder activities, FCUs are authorized to act as an intermediary between their members and outside parties for the sole purpose of bringing the parties together. Although this activity may subject an

FCU to reputation risk by identifying particular vendors to its membership, an FCU does not represent the vendor or the member when the two parties negotiate or enter into a transaction. Finder activities differ from the category of marketing activities because, as the ''finder,'' an FCU simply identifies an outside party with a product or service the FCU believes its members would be interested in obtaining. The category of marketing activities consists of an FCU's promotion or marketing of its own products and operation.

One commenter asked that the finder activities category include the finding of real estate brokers and agents, but that NCUA warn FCUs to comply with other applicable laws, such as the Real Estate Settlement Procedures Act. Similarly, another commenter suggested that the rule authorize FCUs to offer real-estate services under their finder authority, including assistance to members in finding a home mortgage loan, real estate broker or real estate agent. One commenter asked that NCUA allow debt and budget counseling to members through third-party arrangements. An FCU may act as a finder for a variety of products or services that it finds suitable to introduce to its members. An FCU may find real estate brokers or insurance companies, among the numerous possibilities. Therefore, the Board, has removed any reference to a particular product or service in the final rule. This category simply provides examples of types of finder activities.

The proposed rule specifically noted that the offering of a third party's insurance products as an example in the category of finder activities. One commenter found that the insurance products or activities listed in the category could be construed to limit an FCU's offering of insurance products to only those listed, all of which are related to the share or loan products. One commenter stated that the activities listed in the rule should include property and casualty insurance products. Another commenter requested that this category also include long-term care insurance products. One commenter found the regulatory text unclear as to whether FCUs could offer automobile, term and whole life, homeowner's liability, and healthcare insurance products. As mentioned above, the Board recognized from the comment letters that, for clarity, the rule should avoid references to particular products offered by third party vendors. Therefore, while insurance products from third party insurers are examples within the category of finder activities, the Board has removed this reference from the regulatory text. FCUs are not limited in the types of products they may introduce to their members. Rather, an FCU must exercise judgment and due diligence when choosing to introduce or bring together an outside vendor with its members.

The Board notes that the final rule describes finder activities to include the sale of statistical information about an FCU's membership and consumer financial information to outside vendors to facilitate the sale of their products to members. The Board reminds FCUs that, as discussed throughout the preamble, although an activity is authorized as within an FCU's incidental powers, an FCU must comply with all applicable laws prior to engaging in the activity. FCUs must comply with NCUA's privacy of consumer financial information regulation (12 CFR part 716), the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*) and any applicable state laws before selling or otherwise communicating consumer information to third parties.

Loan-Related Products

This category recognizes the ability of FCUs to engage in credit-related activities to protect the FCU against credit-related risks. The FCU Act grants FCUs the express authority to lend. 12 U.S.C. 1757(5) In a lending transaction, the terms of a loan include interest rates, payment dates, and the consequences of default, such as repossession. This category provides examples of activities, services, or products an FCU may negotiate and provide to its members that are incidental to the exercise of an FCU's express power to lend. The Board notes, however, that FCUs must ensure that members receive all of the necessary consumer protections provided in applicable laws and regulations, such as the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and Regulation Z, 12 CFR part 226, so that members make informed choices about whether to purchase these ancillary products or services.

In the proposed rule, the Board identified debt cancellation and debt suspension agreements as permissible activities within the incidental powers of FCUs. The proposed rule, however, placed these activities within the category of finder activities. Three commenters asked that the final rule create an additional category for certain two-party agreements such as debt cancellation, payment suspension and waiver products. The Board agrees that these two-party agreements between an FCU and its member are not finder activities but activities engaged in directly by the FCU with its member to mitigate loan loss.

Both debt cancellation and debt suspension agreements provide a convenient and useful way for an FCU and its members to manage the risk of nonpayment due to financial hardship. FCUs receive compensation for assuming the risk of nonpayment and the additional cost of foregoing the collection of principal or interest. These agreements are appropriate financial tools for FCUs and their members. They provide a source of compensation to the FCU for the credit risk implicit in a lending transaction, and they protect the member from credit damage during a period of financial hardship. Similarly, FCUs may negotiate compensation for uninsured physical damage loss to repossessed property used in a lending transaction.

To clarify the extent of this category further, the Board also has identified two, additional products that NCUA has long considered to be within the incidental powers of FCUs: Leases and letters of credit. The preamble of the Board's recent final leasing regulation contains a discussion regarding an FCU's authority to engage in direct or indirect leasing. 65 FR 34581 (May 31, 2000). A letter of credit is a commitment on the part of the issuing FCU that it will pay a draft presented to it under the terms of credit. If the obligation is to be discharged by the payment of money into a share account, the letter of credit is incidental to the creation of the account. If the obligation is to be discharged by a loan to the member, then the letter of credit is incidental to the FCU's loan commitment under its lending authority. In either case, the letter of credit is incidental to an expressly granted power.

Marketing

This section states that credit union management may use its longstanding incidental power to advertise and market its services in any legally permissible manner. The Board received no comments on this category and has adopted it in the final rule as proposed. The Board has added language to the final rule to clarify that an FCU may market membership in the credit union, as well as the products and services offered to members.

Monetary Instruments

This section allows an FCU to provide monetary instrument services to its members. This section derives from and expands on the express authority of an FCU ''to sell to members negotiable checks (including travelers checks), money orders and other similar money

transfer instruments; and to cash checks and money orders for members, for a fee. * * *'' 12 U.S.C. 1757(12).

The section allows an FCU to maintain deposits in foreign financial institutions to facilitate member transactions. The provision does not, however, allow an FCU to maintain foreign accounts for speculative purposes.

Two commenters requested that this provision include check-cashing authority for nonmembers. As noted above however, this section of the rule is based on expressed statutory authority that is limited to members. Also, one commenter requested the authority to offer international monetary transfer services to both members and nonmembers. International monetary transfers for members are included as a permissible service in this section.

There may be circumstances where it would permissible to provide a monetary service to a nonmember, for example cashing paychecks issued by the credit union's sponsor company. Any other circumstance that might warrant the provision of monetary services to certain nonmembers would necessarily be addressed on a separate basis, outside the scope of this section.

One credit union commenter requested authority to provide services under this category to an underserved community. As stated in the excess capacity discussion, the Board does not find legal justification for establishing a different analysis of the incidental powers of FCUs based upon an FCU's field of membership. The Board notes, however, that there are two other ways in which low-income individuals may receive FCU services. First, FCUs may apply to add underserved areas to their fields of membership without regard to the location of the underserved area. The requirements and process for adding an underserved area are set out in the NCUA Field of Membership and Chartering Manual (NCUA Chartering Manual). NCUA Chartering Manual, Chapter 3, Section III. Once added, anyone in the underserved area is eligible to join the credit union. Second, an FCU with a low-income designation may open share accounts, including regular share, share certificate and share draft accounts, for nonmembers. 12 U.S.C. 1757(6); 12 CFR 701.32. 701.34; NCUA Chartering and Field of Membership Manual (Chartering Manual), Chapter 3, Section II.B.

Operational Programs

The final rule identifies certain operational programs as within an FCU's incidental powers. Operational programs are programs that an FCU establishes within its business to establish or deliver products and services that enhance member service and promote safe and sound operation. One commenter asked NCUA to expand the operational programs category to include the following activities: Money orders, remote cash dispensing, savings bond purchases and redemptions, drafts (vehicle and sight), collections, traveler's checks, cashier's checks, tax payment services, treasury security redemptions, and wire transfers. Another commenter suggested that the category of operational programs include, in addition to safe deposit boxes, other repositories for items of value. The Board has included several of these suggestions in the final rule. The Board excluded the remaining suggested programs because they are already within an FCU's express powers, within another incidental powers activity category such as monetary instruments, or substantially similar to examples in this category.

Stored Value Products

This category in the final rule identifies stored value products or alternate media as within an FCU's incidental powers. As noted in an OCC decision, these products represent a member's prepayment for a merchant's goods or services and are, therefore, a form of bill payment. OCC Interpretive Letter No. 718 (April 1996). An FCU simply transfers funds from a member's share account to a merchant's account. The FCU acts as an intermediary by transferring funds from a member to a merchant, a traditional role for FCUs. Therefore, the activity poses no more additional risk than that already assumed by credit unions.

Two commenters suggested that the definition of stored value products should include products to which an FCU transfers non-monetary information of value to members. These commenters did not elaborate on the type of information or product they envisioned. The Board has determined to leave this category unchanged from the proposed but recognizes that developing technology may affect future interpretation of this category.

Trustee or Custodial Services

Although FCUs do not have express trust powers under the FCU Act, they have long served as trustees and custodians where that authority has been granted under other provisions of law such as the Internal Revenue Code. Under this authority, FCUs are able to provide individual retirement accounts (IRA), education saving accounts such as the Roth IRA, and other savings opportunities that are of importance to modest savers. The ability of FCUs to provide these saving opportunities to their members fits within the historic role of FCUs in encouraging thrift among their members and creating a source of credit for provident purposes.

Four commenters suggested that NCUA authorize FCUs to offer full trust company services to members. The Board disagrees. Under the National Bank Act, the OCC is authorized to ''grant by special permit to national banks * * * the right to act as trustee, executor, administrator * * * or in any other fiduciary capacity in which State banks, trust companies, or other corporations * * * are permitted to act'' in the state in which the bank is located. 12 U.S.C. 92a. The FCU Act does not provide equivalent authority for FCUs to act in a fiduciary capacity for its members.

Two commenters suggested that this category include medical savings accounts. Likewise, one of these commenters recommended that the category of trustee or custodial services include special accounts for first-time homebuyers or other similar accounts authorized under state law. The Board will not include the accounts suggested by the commenter at this time. The Board is considering an amendment to part 724 to authorize FCUs to serve as trustees for tax-deferred medical savings accounts but has not yet made a determination. *See* 64 FR 55871, 55872 (October 15, 1999). As for those accounts created under state law, NCUA evaluates each statute to ascertain whether an FCU has only limited custodial responsibilities under the governing law.

Section 721.4 How May a Credit Union Apply To Engage in an Activity That Is Not Preapproved as Within a Credit Union's Incidental Powers?

This section allows FCUs to seek approval from NCUA to engage in an activity that is not within the ambit of the broad categories in the rule. It provides that an application for a new activity is treated as an application to amend the regulation. It does not set time frames in which NCUA must respond to a request for a new activity or category although the preamble to the proposed rule states that ''NCUA will endeavor to respond * * * within 60 days as to whether it will propose an amendment.'' 65 FR 70526, 70531 (November 24, 2000). This section also permits FCUs to seek an advisory opinion from NCUA's Office of General Counsel before engaging in the petition process to determine whether a proposed activity fits into one of the

authorized categories or is otherwise within an FCU's incidental powers. Thirty-three commenters supported the proposed application process. Seven commenters approved of an application process but suggested that NCUA amend the process. One commenter supported the voluntary nature of the process and agrees that FCUs will rarely need to use the process.

Nine commenters asked that the proposed rule place a time limitation on NCUA to respond to an applicant seeking approval of an activity or category not previously approved as within the incidental powers authority. These commenters suggested various time frames. The Board believes that setting a time frame to act on an application could result in less activities being approved. These activities may involve complex issues that require not only a thorough legal analysis but an assessment of risk. The Board's experience in dealing with the issue of incidental powers leads it to believe that maximum flexibility is necessary when reviewing these applications. Although the applicant may want an expeditious decision, most importantly, it wants a correct decision. This decision is not only important for the applicant but also for the agency and the National Credit Union Share Insurance Fund. The Board, therefore, is not setting a definitive time frame for rendering a decision, but will attempt to notify an applicant anytime a decision cannot be reached within 60 days. The Board is cognizant of the need for an applicant to receive a decision as soon as reasonably possible. Accordingly, every effort will be made to process and consider all applications expeditiously for approval of an activity or category not previously approved as within the broad incidental power categories.

One commenter supported the NCUA's Office of General Counsel's authority to determine whether an activity not found within the list of categories is permissible under the incidental powers of an FCU. One commenter disagreed with this approach. One commenter requested that the final rule clarify that an FCU need only seek an advisory opinion from the Office of General Counsel if a proposed activity clearly fails to fall within one of the preapproved categories. This commenter is correct. If a proposed activity does not appear to fall within one of the preapproved categories, FCUs may seek an advisory opinion from the Office of General Counsel as to whether the activity fits within a category or is otherwise an incidental powers activity.

A number of commenters misconstrued the Board's description of the review and approval process for activities that are not provided as examples within the preapproved categories. In general, these commenters were confused about when the General Counsel advisory opinion process is used and when it would be necessary to apply to the Board to amend the regulation. Forty-nine commenters generally opposed the use of categories and the application process. Many of these commenters found the application process burdensome and recommended a more streamlined process or no application process at all. Again, the Board believes some of these commenters misconstrued how the Board intends the process to work.

The Board wishes to clarify how it intends the process to work and the analytic steps an FCU should follow in determining if an activity is permissible. The activities listed under the broad categories are intended as illustrations, not an exhaustive list of what is permissible under the categories set out in the rule. Therefore, the first step, if an FCU does not find an activity identified in the rule, is to consider whether, although not listed as a specific example, it is within the ambit of one of the broad categories in the rule. If an FCU concludes that it is within the ambit of one of the broad categories of the rule, an FCU need not contact NCUA for a legal opinion or apply for an amendment of the rule. FCUs are encouraged to consult with their own legal counsel in making this determination.

Second, if an FCU is not sure if an activity fits within a preapproved category, it may request a legal opinion or consult informally with NCUA's Office of General Counsel. AnFCU is not required to obtain an opinion from NCUA's Office of General Counsel, however, there are several advantages in doing so. If it is unclear whether an activity is permissible, an FCU runs the risk of engaging in an impermissible activity and being subject to supervisory action. NCUA, not FCUs, has the discretion to determine if an activity is within an FCU's incidental powers. The Office of General Counsel, which is specifically authorized to provide the public with legal interpretations of the FCU Act andNCUA regulations, 12 CFR 790.2(b)(8), may determine that an activity is already covered by one of the rule's broad categories although not specifically identified. The Office of General Counsel may also, as it has done in the past, render a legal opinion that an activity is a permissible exercise of an FCU's incidental powers even though the activity is not covered by the broad categories in the rule. The Board contemplates that new activities identified by the Office of General Counsel will be routinely added to the rule as part of the Office of General Counsel's ongoing regulatory review process.

Third, an FCU may go through the application process set out in the rule. The Board wants to reiterate that it believes the application process will rarely be necessary because of the manner in which the categories are set out in § 721.3.

One commenter stated that the rule should require an FCU applicant to include only a description of the proposed activity, an explanation of how the activity qualifies as an incidental power and any other information as necessary to describe the activity. This commenter noted that the rule should not require the applicant to provide any business considerations in the application. Two commenters stated that NCUA's determination to approve an activity should not be based on whether it is a good business decision for the particular applicant but whether the activity is within the incidental powers of all FCUs. In general, the Board agrees that business considerations should not be part of the decision on whether an activity is deemed incidental and has modified the rule accordingly. Three commenters requested that the final rule clarify that an activity approved for one applicant is permissible for all FCUs. The Board agrees with this comment and is clarifying that once an activity is approved for one credit union it is legally permissible for all FCUs to engage in this activity.

Finally, most of the commenters who objected to the application process favored a flexible approach that they contend is similar to the OCC's. They advocated an incidental powers analysis whereby NCUA establishes broad parameters of what constitutes a permissible activity so that FCUs could determine whether an activity falls within their incidental powers. These commenters requested that the final rule grant FCU boards of directors or their private attorneys the ability to assess whether an activity is legal without seeking approval from the NCUA. Many commenters also objected to the statement in the proposed rule's preamble that indicates NCUA may reach a different conclusion in its analysis of incidental powers than the OCC. Two commenters suggested that NCUA should routinely review the powers granted to banks and conclude that these activities are permissible for

FCUs unless they pose safety and soundness concerns or are contrary to the FCU Act. These commenters apparently misunderstand the OCC's approach.

Banks and their operating subsidiaries may engage in activities the OCC has authorized through regulations as within the powers of a bank. In addition, the OCC determines whether a novel activity is within the business of banking or incidental thereto, through interpretive letters that rely on the facts presented by the applicant. As explained earlier, NCUA has the authority and responsibility to determine whether an activity is incidental. The Board believes it cannot and should not delegate that authority and responsibility. The Board is concerned about potential safety and soundness concerns as well as the problems that could ensue if an FCU invested a significant amount of personnel and dollars in an activity that was later determined to be impermissible. Finally, an FCU's incidental authority is different than the incidental authority of a bank and, therefore, requires a distinct and separate analysis.

Section 721.5 What Limitations Apply to a Credit Union Engaging in Activities Approved Under This Part as Within a Credit Union's Incidental Powers?

This section acknowledges the distinction between an FCU's authority to engage in an activity deemed to be within its incidental powers and the requirement that an FCU comply with any conditions or regulations that apply to the activity. When engaging in an authorized activity, FCUs must comply with conditions or constraints on the activity established in applicable federal and state law, NCUA regulations, and legal opinions. For example, FCUs are responsible for ensuring their compliance with applicable state licensing laws relating to insurance sales. Another example is the use of raffles in promotional activities that may be regulated or prohibited under local law. The regulation does not preempt FCUs from compliance with these laws.

One commenter suggested that the Board remove this section as unnecessary because FCUs are already obligated to obey such laws. The Board disagrees. The Board believes that including this provision enhances awareness of the compliance risk involved in new activities. Before engaging in any of the activities identified in the final rule, FCUs must ascertain whether they need to obtain licenses or meet other legal requirements before engaging in an activity.

Section 721.6 May a Credit Union Derive Income From Activities Approved Under This Part?

The proposed rule provided that an FCU may receive unlimited compensation from its incidental powers activities. For finder activities, the proposed rule would allow FCUs to charge third parties that solicit members through the FCU.

One hundred and forty-one commenters agreed that compensation should be unlimited. Although FCUs are currently authorized to conduct administrative work in connection with a group purchasing activity and receive reimbursement of their cost amount for extending group purchasing plans, many commenters supported the proposal because they stated a need to increase income due to decreasing operating and interest rate margins. Those in support of this provision uniformly stated that only the business decisions of FCU directors should limit the amount of income an FCU receives when engaging in incidental powers activities. Two credit union commenters objected to the ability of FCUs to obtain unlimited compensation from their incidental powers. In light of the overwhelming number of comments in favor of proposed § 721.6 and the fact that this derivation of income is simply an extension of fees the FCU already has received in connection with the current group purchasing authority, the Board is adopting this section in the final rule as proposed.

Section 721.7 What Are the Potential Conflicts of Interest for Officials and Employees When Credit Unions Engage in Activities Approved Under This Part?

This section prohibits senior management employees, officials, and their immediate family members from receiving any compensation or benefit, directly or indirectly, from activities covered in the regulation. Of the twenty-four commenters that expressed an opinion on the conflicts of interest provision, fourteen stated that the provision is adequate. One stated that the provision prevents the misappropriation of funds and is in the best interests of an FCU's membership. Nine commenters suggested several amendments to this section. One commenter suggested that the reference to ''indirectly receiving'' requires clarification because it could be subject to wide interpretation. The preamble to the proposed rule stated that this section only prohibits compensation that is linked to products or services provided by third party vendors. In addition, the NCUA Board provided an example of compensation that is not prohibited. 65 FR 70526, 70531 (November 24, 2000).

One commenter requested that the final rule clarify proposed § 721.7(a). Two commenters believed that the reference to compensation received ''directly or indirectly'' could disallow salaries for senior management. The Board is clarifying that this conflicts of interest section does not prohibit salaries for senior management.

Four commenters stated that the rule should allow senior management to receive bonuses or incentives for finder activities or other incidental powers activities. The Board disagrees. As with other activities that can lead to significant abuse, the Board believes senior management should be primarily concerned with the financial health of the institution and be free from the undue influences of third party vendors. Such a prohibition is a good policy for the FCU, its members and ultimately senior management officials. Avoiding the appearance of a conflict of interest will insulate senior management from charges that their business decisions are based on their own pecuniary interest. This type of conflict of interest provision adopted in the final rule has worked extremely well in the context of other NCUA regulations and the Board believes such a provision is necessary in the context of expanded incidental powers activities.

One commenter asked that the rule establish an exception allowing an official to receive dividends from publicly traded corporations if the official does not have a material ownership interest in the corporation. The Board wishes to clarify that the conflict of interest provision does not apply to the situation presented by this commenter.

One commenter stated that § 721.7(b) is inconsistent with the conflicts provision of NCUA's lending regulation, which governs compensation in connection with any loan made by an FCU. 12 CFR 701.21(c)(8). This commenter asserted that many third party loan-related products and services will be offered under part 721 and that compensation arrangements related to these products and services will be subject to different requirements under the two rules. The Board appreciates the need to provide further guidance regarding the final rule's conflict of interest provision and has amended the language in the final rule to simplify this provision consistent with the Board's intent and other conflict of

interest provisions throughout NCUA's regulations.

As noted above, the final rule prohibits compensation to a senior management employee, official, or his or her immediate family member that is received directly or indirectly by such individual as a result of third-party products or services. The Board does not prohibit compensation to these individuals, however, if the compensation is: (1) Fixed in amount; (2) not related to the amount of products sold or services used; and (3) received by no more than one director or official of the credit union, who is recused from the credit union decision concerning its business with the third party vendor. The Board again provides the following example of permissible compensation:

An FCU official, Ms. Smith, is also on the board of directors of Company DMH, which sells phone cards. Ms. Smith is paid $5,000 a year by Company DMH for her services as a director. The FCU contracts with Company DMH to provide prepaid phone cards to its members. Ms. Smith is not involved in the decision making process, and her compensation from the DMH Company is not linked to the FCU's phone card sales.

The rule also prohibits compensation to non-senior management employees or their immediate family members that is received directly or indirectly by such individual as a result of third-party products or services, unless the FCU's board of directors has established written policies regarding third-party compensation and has determined that no conflict of interest exists. This provision allows employees to receive compensation from persons other than the FCU provided that the employee's relationship with the third-party does not conflict with the interests of the FCU or its members.

Under this exception, an employee may not receive a commission or other compensation from a third-party for referring members to the third-party because an inherent conflict exists in the employee's promotion of a particular third-party product or service for the employee's pecuniary interest. If the employee's motivation is purely self-interest, this incentive works to the detriment of the FCU or its members. The final rule, however, allows the FCU to pay incentives to non-senior management employees in connection with incidental powers activities when an FCU's board of directors determines that an incentive or bonus is an appropriate means to promote its business as an FCU. In addition, the final rule permits employees to receive compensation from a third-party when no conflict of interest exists, such as in a dual employment scenario when the employee's position outside of the FCU does not affect the FCU.

These restrictions are consistent with the intent of NCUA's other conflicts of interest provisions. The Board, however, maintains that conflicts of interest provisions tailored to particular activities are still necessary. Therefore, individuals affiliated with FCUs are still required to comply with conflicts of interest provisions within other sections of NCUA's regulations. The final rule provides that where a specific conflicts of interest provision applies to a particular activity, that provision controls the conduct of the parties. For example, the conflicts of interest provision in the lending regulation was adopted to ''ensure that lending decisions are made in the best interests of the credit union and its members, and not in the personal interests of individual officials or employees.'' 48 FR 52475 (November 18, 1983). The Board continues to believe that this provision in the lending regulation is necessary to promote the safety and soundness of FCUs. Therefore, individuals subject to the conflicts of interest provision in the lending rule remain subject to this provision when offering loan-related products, an activity authorized under part 721.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small entities. For purposes of this analysis, credit unions under $1 million in assets will be considered small entities.

The Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small entities. This rule identifies activities that FCUs are authorized to engage in under their incidental powers without imposing any additional regulatory burden or expense to credit unions. Accordingly, NCUA has determined that a Regulatory Flexibility Analysis is not required.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

Paperwork Reduction Act

NCUA has determined that the proposed regulation does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule applies only to federally-chartered credit unions. It will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 721

Credit unions.

By the National Credit Union Administration Board on July 26, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 749

Records Preservation Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is revising its regulation establishing standards for vital record preservation. The revised regulation clarifies that a credit union may preserve records in electronic form, as authorized by the Electronic Signatures in Global and National Commerce Act. The revision permits a credit union's board of directors to determine which employee will be responsible for storing vital records under the record preservation program, in contrast to the current regulation which names the credit union's financial officer. It also incorporates an appendix to provide suggested guidelines to credit unions on retention periods for various types of records.

EFFECTIVE DATE: This rule is effective September 4, 2001.

FOR FURTHER INFORMATION CONTACT: Dianne M. Salva, Staff Attorney, Division of Operations, Office of General Counsel, at 1775 Duke Street, Alexandria, Virginia 22314, or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

NCUA published a proposal to revise its regulation governing the preservation of vital records. 66 FR 11239, February 23, 2001. At the end of the sixty-day public comment period, NCUA had received eleven comment letters. After carefully considering the comments, the NCUA Board is publishing this final rule, which is substantially identical to the proposal. Only one minor change was made to the appendix to the regulation: the reference to 5300 financial reports as semiannual and annual filings has been omitted since some credit unions now file such reports quarterly.

The revision makes three substantive modifications to the regulation and changes the format to question and answer. First, the revision clarifies that credit unions may store records in any format that is accurate, accessible and capable of being reproduced by printing, transmittal or other methods, as permitted by the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001. Second, it permits a credit union's board of directors to determine which employee will be responsible for carrying out the vital record preservation duties. The current regulation requires that the credit union's financial officer be designated as responsible for those duties. Third, to address the need for guidance about record retention, the revision incorporates an appendix on recommended retention periods for various types of credit union records.

Comments

NCUA received eleven comment letters, all of which expressed general support for the proposal. Four comments letters were from credit unions; two were from national credit union trade associations; four were from state credit union leagues; and one was from a credit union service provider.

Eight commenters strongly supported the change to the regulation to clarify that credit unions may retain records electronically.

Five commenters expressed approval for the addition of the appendix containing record retention guidelines. Of these, three suggested various changes in the guidance for retention periods and types of records that must be retained. The NCUA Board notes that the record retention guidelines are merely recommendations and credit unions may adopt other retention periods for these or other types of records.

Five commenters strongly supported the change to the regulation permitting a credit union's board of directors to determine which employee will be responsible for vital record preservation. Two commenters favored eliminating the requirement that the credit union's financial officer be responsible for vital records preservation but suggested that the credit union manager, rather than the board should determine which employee to designate. The NCUA Board did not adopt that suggestion in the final rule. The Board believes that a credit union's board of directors is in the best position to know who among the credit union staff should be responsible for carrying out the important responsibilities of the vital records preservation program. In revising this regulation to eliminate the requirement that designated the financial officer as responsible, the NCUA Board does not want to replace it with another provision removing the ability and responsibility of a credit union's board of directors to make the selection itself.

NCUA requested comment concerning whether the rule is understandable and minimally intrusive. One commenter praised the rule for being clear and understandable. Two commenters expressed dislike for the question and answer format. One commenter, while acknowledging that the proposal is designed to be more user friendly, questioned whether the question and answer format makes the rule easier to understand. The NCUA Board finds that the question and answer format is understandable and is appropriate for this regulation. One commenter suggested that additional records, sufficient for auditing or to detect fraud, should be included among vital records. Two commenters suggested that the term ''vital record'' should be defined with more specificity and the description should be augmented with more examples. The Board notes that the proposed rule did not materially alter the description of vital records from that in the current regulation. To give credit unions maximum flexibility, the description of vital records is brief and lists only the minimum types of records included. A credit union may include additional records it determines would be necessary to carry on its business in the event of a catastrophe.

Regulatory Procedures

Paperwork Reduction Act

This regulation will impose no additional information collection, reporting or record keeping requirements.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 605(b)), NCUA certifies that these amendments will not have a significant economic impact on a substantial number of small entities. NCUA expects that these regulations will not: (1) Have significant secondary or incidental effects on a substantial number of small entities; or (2) create any additional burden on small entities. Accordingly, a regulatory flexibility analysis is not required.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the Executive Order. Since this regulation will only apply to federal credit unions, it will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and

responsibilities among the various levels of government.

Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget has determined that this rule is not major for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 749

Archives and records, Credit unions, Reporting and recordkeeping requirements.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 712

Credit Union Service Organizations (CUSOs)

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is revising its rule concerning federal credit union (FCU) investments in and loans to credit union service organizations (CUSOs). The first change clarifies that the list of permissible activities in the CUSO regulation is intended to establish broad categories of permissible activities. The listing of particular activities under these categories is for illustrative purposes and not exhaustive of activities that may be permissible. In conjunction with this change, the provision for adding new activities to the regulation is amended to encourage FCUs to seek an advisory opinion from the Office of General Counsel on whether a proposed activity falls within one of the authorized categories before requesting a regulatory amendment. The final change adds a federally-chartered corporation to the category of permissible structures for CUSOs.

DATES: This rule is effective September 4, 2001.

FOR FURTHER INFORMATION CONTACT: Mary Rupp, Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

On February 15, 2001, the NCUA Board requested comment on proposed changes to part 712 of its regulations. 66 FR 11125 (February 22, 2001). Part 712 sets forth the requirements for FCUs investing or lending to CUSOs. The first proposed amendment was a clarification of an existing authority and the second proposed amendment was an expansion of an existing authority.

Summary of Comments

The NCUA Board received 26 comments on the proposal: 16 from credit unions; one from a CUSO; two from credit union trade groups; one from a CUSO trade group; five from credit union leagues; and one from a bank trade group. Below is a summary of the comments.

Clarification That the List of Permissible Activities Establishes Broad Categories and the Particular Activities Under These Broad Categories are for Illustrative Purposes

The first proposed change clarified that the list of permissible activities in § 712.5 is intended to establish broad categories of permissible activities and that the listing of particular activities under these broad categories is for illustrative purposes and not meant to be exhaustive. Nineteen commenters fully supported the proposed change; five commenters objected because they thought the change should be more expansive; and one commenter, the bank trade group, objected to the expansion. The commenters in support of the proposal noted that the amendment would allow the rule to accommodate technological advances and a broader scope of business practices, as well as allow CUSOs to offer a variety of new and innovative products that will fit within the general categories. One of those commenters noted that the proposal provides an adequate illustration of the types of activities that are permissible without the loss of flexibility that would result from a list of specific activities. One commenter noted that the approved list of activities is only the beginning of what a CUSO can do and with the test of ''relate to the routine daily operations'' there is sufficient guidance.

Some of the commenters in support of further expansion suggested using the same approach as the approach taken in the incidental powers proposal. This amendment, in fact, is modeled after the incidental powers proposal. One commenter suggested using the same test for permissibility of a CUSO activity as is used to determine permissibility of an incidental powers activity. This commenter fails to recognize that the legal authority for an incidental powers activity is different from the legal authority for a CUSO activity. Incidental powers activities are governed by § 1757(17) of the Federal Credit Union Act (Act) and CUSO activities are governed by § 1757(5)(D) and (7)(I) of the Act. The statute is clear that an activity that is necessary for a credit union to carry on effectively the business for which it is incorporated is a permissible incidental powers activity. This is different than the statutory standard for a permissible CUSO activity, which is limited to activities that relate to the routine daily operations of credit unions.

A few commenters suggested the list is too restrictive, should include more examples, and should be an appendix to the rule, rather than in the rule. When the Board revised the list of permissible CUSO activities in its 1998 overhaul of the CUSO rule, an effort was made to include all permissible activities relating to the routine operations of credit unions. 63 FR 10743 (March 5, 1998). The Board is not aware of any activities relating to the routine operations of credit unions that were not either, considered and rejected, or included at that time and so, it will not be revising the list.

One commenter suggested adding business loan origination and consumer loan origination to the list of permissible activities. The Board specifically addressed both business and consumer loan origination in its 1998 revisions to the CUSO regulation and has not changed its view as to the proper role of CUSOs in this area.[1] As it noted then, the Board believes that, while CUSOs are not authorized to originate consumer loans, other than mortgage loans, or business loans, they may provide support services to credit unions for both types of loan.

Suggestion To Seek an Advisory Opinion From the Office of General Counsel (OGC)

Fifteen of the 20 commenters that responded to this issue supported the proposal. One of those commenters noted that this provision is especially helpful because it does not require an opinion if the credit union believes the activity is within the stated categories and can justify it if challenged.

Only one of the five negative commenters, the bank trade group, objected to this provision because it is too permissive. Some of the negative commenters suggested that the decision

[1] Regarding consumer and business loan origination as a CUSO activity, the Board stated:

After due consideration of the comments, NCUA remains opposed to this addition [consumer loan origination]. Unlike consumer mortgage loan origination, which requires a specialized lending staff, must follow strict secondary mortgage market rules, and requires economies of scale in order to be viable, consumer loans are relatively easy to offer and process. In addition, NCUA is apprehensive in granting CUSOs the authority to provide consumer loans to the general public, as it may be perceived as a dilution of the common bond by Congress and the public.

* * * [W]hile CUSOs can only approve and fund consumer mortgages and student loans, CUSOs can engage in many back office aspects of lending * * *. In essence, CUSOs can provide back office underwriting, processing and servicing functions to enable a credit union to offer loans * * *. In other words, FCUs are permitted to leverage their member business loan expertise with CUSO business loan personnel. This clarification is made to assist FCUs in expanding the number and type of business loans made to its members in conjunction with the member business loan amendments proposed in 62 FR 41313 (August 1, 1997).

Id. at 10752.

of whether an activity falls within a broad category should be made by the credit unions and their attorneys, not NCUA. The Board agrees and states that the rule does not require a credit union to come to OGC for an opinion every time a CUSO wants to engage in an activity not specifically listed as an example under a broad category. An opinion from OGC is recommended if there is doubt as to whether a specific activity falls within one of the broad categories or a new broad category is being proposed. In those situations, an FCU that doesn't consult with OGC runs the risk of engaging in an impermissible activity and being subject to supervisory action.

One commenter suggested that if an activity is ''convenient and useful'' the credit union's attorney should decide if it is permissible. As noted above, the test for CUSOs is not the ''convenient and useful'' test associated with incidental powers activities. The test for CUSOs, as stated in the rule and the Act, is that the activity must relate to the ''routine, daily operations of credit unions.'' 12 U.S.C. 1757(7)(I); 12 CFR 712.5.

Addition of a Federally-Chartered Corporation as a Permissible CUSO Structure

The 21 commenters that responded to this issue agreed with allowing a federally-chartered corporation as a permissible CUSO structure. A few of those commenters suggested that the Board define ''depository institution'' in the CUSO rule so as to exclude from the definition an institution principally engaged in the business of providing trust services that holds only such deposits as are required to qualify for FDIC insurance. The commenters requested this definition so that a CUSO could obtain a trust charter from the Office of Thrift Supervision (OTS).

While the Act prohibits an FCU from acquiring control directly or indirectly of a financial institution, trust services have been identified as a permissible activity for CUSOs for almost twenty years. 12 U.S.C. 1757(7)(I); 47 FR 30462 (July 14, 1982). The NCUA's long-standing interpretation of financial institution has been that it means a deposit taking institution. 51 FR 10353, 10354 (March 26, 1986). The CUSO regulation reflects this policy and states that FCUs may not acquire control of ''another depository financial institution.'' 12 CFR 712.6. Thus, NCUA has viewed trust companies as permissible CUSOs as long as they were not deposit taking organizations.

The OTS requires Federal Deposit Insurance Corporation (FDIC) insurance for all institutions it charters. 12 CFR 543.2. Under the Federal Deposit Insurance Act (FDI Act), an applicant for insurance must be ''engaged in the business of receiving deposits other than trust funds.'' 12 U.S.C. 1815(a)(1). In March 2000, the FDIC interpreted this requirement in General Counsel Opinion No. 12, stating that this requirement can be satisfied if an institution maintains one or more non-trust deposit accounts in the aggregate amount of $500,000. 66 FR 20102, Appendix (April 19, 2001). The opinion was intended to clarify the meaning of the requirement, particularly in the context of the FDIC's long-standing interpretation of non-traditional depositories such as trust companies.

Recently, the FDIC issued a proposed rule that would incorporate its General Counsel Opinion No. 12. 66 FR 20102. The proposed rule contains an extensive discussion of the ambiguity of the FDI Act and various factors that led to issuance of the legal opinion. The impetus for the proposed rule is a recent federal court decision, discussed in the preamble to the proposed rule, in which the court disagreed with the FDIC's interpretation of this requirement. The FDIC states that the inconsistency between its interpretation and that of the court could have harmful results and has determined to address the issue in a rulemaking. *Id.* at 20105.

While the Board agrees with the commenters that ''depository financial institution'', as used in 12 CFR 712.6, should not include a financial institution principally engaged in the business of providing trust services, and which holds only such deposit as is required for FDIC insurance, the Board is not inclined to include a definition in the regulation at this time. A regulatory definition adopted now might not adequately address issues that will be considered in the FDIC's rulemaking or in the pending litigation. Further, the Board does not believe it is necessary to include a definition as part of the regulation but, as necessary, NCUA's Office of General Counsel may provide further interpretation, in addition to that stated in this preamble.

One commenter suggested an FCU's trust powers be expanded in NCUA's incidental powers rule and that the Act be amended to allow NCUA to charter trust companies. Another commenter suggested adding a new structure that would allow a CUSO to be established under foreign law so that it could serve foreign nationals. These suggestions are outside the scope of this rulemaking process.

Final Amendments

Section 712.3(a)

The Board is revising this provision to include federally-chartered corporations as a permissible CUSO structure.

Section 712.5

The Board is adding a sentence to this section to state plainly that the listings under the broad categories are for illustrative purposes and not intended to be an exclusive or exhaustive list of permissible activities.

Section 712.7

The Board is amending the provision for adding new activities to the regulation to advise FCUs to seek an advisory opinion from OGC as to whether a proposed activity fits into one of the authorized categories before requesting a regulatory change to add a new activity. An FCU is not required to seek an advisory opinion if a proposed activity, not listed as an example, clearly falls within one of the broad categories approved by the Board.

This amendment in conjunction with the change to § 712.5 will reduce regulatory burden by allowing the rule to expand as technology expands.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities (primarily those under 1 million in assets). The amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that this final rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1966 (SBREFA) (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget is reviewing this rule to determine if it is a major rule for purposes of SBREFA.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule will apply only to federally-chartered credit unions. It will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposal does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We requested comments on whether the proposed rules were understandable and minimally intrusive if implemented as proposed. We received three comments on this issue. Two commenters did not address the proposal, but rather stated that the question and answer format of the CUSO rule is confusing. One commenter stated that the proposal does meet the agency's regulatory goal.

List of Subjects in 12 CFR Part 712

Administrative practices and procedure, Credit, Credit unions, Investments, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on July 26, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is issuing a final rule that relaxes certain provisions in NCUA's regulations for advertising and posting notice of nondiscrimination in real estate-related lending. The rule provides a federal credit union (FCU) with flexibility in how it gives notice when advertising and allows an FCU to display either the NCUA lobby poster or a similar poster prepared by the United States Department of Housing and Urban Development. The rule also prohibits advertising with words, symbols, models, or other forms of communication that suggest a discriminatory preference or policy of exclusion in violation of the Fair Housing Act or the Equal Credit Opportunity Act.

DATES: This rule is effective October 19, 2001.

FOR FURTHER INFORMATION CONTACT: Paul M. Peterson, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6555.

SUPPLEMENTARY INFORMATION:

A. Background

In April 2001, the NCUA Board published a proposed rule to relax certain provisions in NCUA's regulations for advertising and posting notice of nondiscrimination in real estate-related lending. 66 FR 20945, April 26, 2001. The Board issued the proposed rule out of concern that the existing requirements were less flexible than the Fair Housing Act and associated United States Department of Housing and Urban Development (HUD) guidance require. 42 U.S.C. 3604(c); 24 CFR 109.30(a) (1995) (removed from CFR by 61 FR 14378, April 1, 1996). This final rule adopts the language of the proposed rule without changes.

The existing rule mandates FCUs give notice of nondiscrimination when advertising real estate-related lending through use of a particular logotype and specific language. The final rule replaces the existing rule's specific requirement with a general requirement that FCUs indicate that they do not discriminate on any prohibited basis. The final rule also provides FCUs with various ''safe harbor'' methods to satisfy this notice requirement. These safe harbor methods are not mandatory. FCUs are free to use any reasonable method to satisfy the requirement.

HUD requires that every entity subject to the Fair Housing Act display on its premises a poster containing specific nondiscrimination language. 24 CFR 110.15. Federal financial regulatory agencies may substitute a different poster, and NCUA has done so. 24 CFR 110.25(b); 12 CFR 701.31(d)(2), (3); 54 FR 21963, May 22, 1989. The final rule permits FCUs to display either the NCUA version or the HUD version of the poster.

The final rule is similar to the Federal Deposit Insurance Corporation's (FDIC) nondiscrimination in advertising rule. 12 CFR 338.3. Both this final rule and the FDIC's rule prohibit advertising with words, symbols, models, or other forms of communication that suggest a discriminatory preference or policy of exclusion in violation of the Fair Housing Act or the Equal Credit Opportunity Act. 12 CFR 338.3(b), 12 U.S.C. 1691–1691f.

B. Comments

NCUA received twelve comments on the proposed rule. The commenters generally supported the proposed rule. Most of the commenters thought the rule would be very beneficial to FCUs and several commended NCUA generally for efforts to reduce regulatory burden on credit unions.

None of the commenters recommended changes to the wording of the proposed rule. One commenter did express concern that the proposed rule might encourage some credit unions to design their own disclosure and logotype formats and that this might create confusion and misunderstanding among some FCU members. The Board notes that, although the final rule provides flexibility in exactly how an FCU gives notice of nondiscrimination, it does require that the notice ''prominently indicate * * * that the credit union makes such loans without regard to race, color, religion, national origin, sex, handicap, or familial status.'' The Board believes an FCU should have the flexibility to design its own notice of nondiscrimination, if it wishes, within the bounds of this requirement.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic effect any regulation may have on a substantial number of small credit unions, meaning those under one million dollars in assets. The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA Board has determined that a regulatory flexibility analysis is not required.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This proposed rule, if adopted, will apply only to federally-chartered credit unions. It will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposal does not constitute a policy that has federalism implications for purposes of the executive order.

Paperwork Reduction Act

NCUA has determined that the proposed rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

The Treasury and General Government Appropriations Act, 1999—-Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this final rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We requested comments on whether the proposed rules were understandable and minimally intrusive if implemented as proposed. We received no comments specifically directed to whether the rule was understandable. Almost all the commenters agreed that the rule reduced the current regulatory burden on FCUs and so was not intrusive.

List of Subjects in 12 CFR Part 701

Credit unions, Fair housing, Signs and symbols.

By the National Credit Union Administration Board, on September 13, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 707

Truth in Savings

AGENCY: National Credit Union Administration (NCUA).

ACTION: Interim final rule; lifting mandatory compliance date.

SUMMARY: On June 21, 2001, NCUA published an interim final rule with request for comments amending its regulation that implements the Truth in Savings Act (TISA). The rule established uniform standards for the electronic delivery of disclosures required by TISA. NCUA established October 1, 2001 as the mandatory compliance date for the rule. As a result of concerns raised by commenters, NCUA is considering revising the rule to provide additional flexibility. Accordingly, NCUA is lifting the mandatory compliance date. Once a permanent final rule is issued, NCUA will afford credit unions a reasonable period of time to comply with the rule.

DATE: The mandatory compliance date of October 1, 2001 for the interim final rule published at 66 FR 33159 (June 21, 2001) is lifted.

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

Part 707 of NCUA's regulations implements TISA. 12 CFR part 707. The purpose of part 707 and TISA is to assist members in making meaningful comparisons among accounts offered by credit unions and other financial institutions. Part 707 and TISA require, among other things, disclosure of yields, fees and other terms concerning share accounts to members at account opening, upon request, when changes in terms occur and in periodic statements. Many of these disclosures must be written.

In April 2001, The Board of Governors of the Federal Reserve System (Federal Reserve) issued an interim rule amending its Regulation DD, which implements TISA (April 2001 Interim Rule). 66 FR 17795 (April 4, 2001). That rule established uniform standards for the timing and electronic delivery of disclosures required by TISA and Regulation DD, and addressed electronic advertisements.

TISA requires NCUA to promulgate regulations substantially similar to those promulgated by the Federal Reserve within 90 days of the effective date of the Federal Reserve's rules. 12 U.S.C. 4311(b). In doing so, NCUA is to take into account the unique nature of credit unions and the limitations under which they may pay dividends on member accounts. In compliance with TISA, NCUA published an interim final rule with request for comments in June 2001 that is substantially similar to the Federal Reserve's April 2001 Interim Rule. 66 FR 33159 (June 21, 2001).

B. Lifting the Mandatory Compliance Date

In August 2001, the Federal Reserve issued an interim final rule that lifted the October 1, 2001 mandatory compliance date. This enables the Federal Reserve to address concerns noted by commenters regarding operational issues raised by the April 2001 Interim Rule. Accordingly, to fulfill our statutory obligation under TISA, the NCUA is also lifting the October 1, 2001 mandatory compliance date.

Credit unions may continue to provide electronic disclosures under their existing policies and practices if they comply with the Electronic Signatures in Global and National Commerce Act (E-Sign Act), as discussed more fully below, or they may follow the interim rule issued by NCUA in June 2001, until the NCUA issues a permanent rule.

C. Withdrawal of the 1999 Interim Rule Unaffected

The E-Sign Act was enacted in June 2000, to encourage the continued expansion of electronic commerce. It generally provides that electronic documents and signatures have the same validity as paper documents and handwritten signatures. It provides that consumer disclosures may be provided in electronic form only if the consumer affirmatively consents after receiving information specified in the statute. The consumer consent provisions in the E-Sign Act became effective October 1, 2000. In September 1999, before enactment of the E-Sign Act, the Federal Reserve issued an interim rule that also amended Regulation DD (September 1999 Interim Rule), but did not specify the manner or form of consumer's consent to electronic disclosures. 64 FR 49846 (September 14, 1999). With the issuance of the April 2001 Interim Rule, which sets forth the general rule that an institution subject to Regulation DD may provide disclosures electronically only if the institution complies with § 101(c) of the E-Sign Act, the Federal Reserve has withdrawn the September 1999 Interim Rule. The lifting of the October 1, 2001 mandatory compliance date has no effect on the withdrawal of the September 1999 Interim Rule.

Interim Final Rule

The NCUA Board is issuing this rule as an interim final rule because there is a strong public interest in having in place consumer oriented rules that are consistent with those recently promulgated by the Federal Reserve. Additionally, as discussed above, NCUA is statutorily required to issue rules substantively similar to those of the Federal Reserve within 90 days of the effective date of the Federal Reserve's rules. Accordingly, for good cause, the Board finds that, pursuant to 5 U.S.C. 553(b)(3)(B), notice and public procedures are impracticable, unnecessary, and contrary to the public interest; and, pursuant to 5 U.S.C. 553(d)(3), the rule will be effective immediately and without 30 days advance notice of publication.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact agency rulemaking may have on a substantial number of small credit unions. For purposes of this analysis, credit unions under $1 million in assets are considered small credit unions.

This interim final rule provides credit unions with the flexibility of voluntarily using an optional and alternative method of delivering certain required disclosures. Credit unions are free to choose not to utilize this alternative. Credit unions that choose to use this alternative will likely realize a reduction in their costs of delivery as a result. The NCUA has determined and certifies that this interim final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that these amendments to part 707 do not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C.

3502(5), voluntarily complies with the executive order. This interim final rule applies to all federally-insured credit unions, but does not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this interim final rule does not constitute a policy that has federalism implications for purposes of the executive order.

Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 707

Advertising, Consumer protection, Credit unions, Reporting and recordkeeping requirements, Truth in savings.

By the National Credit Union Administration Board on September 13, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR PART 707

Truth in Savings

AGENCY: National Credit Union Administration (NCUA).

ACTION: Interim final rule with request for comments.

SUMMARY: NCUA is amending its regulation that implements the Truth in Savings Act (TISA). This interim final rule establishes uniform standards for the electronic delivery of disclosures required by TISA. NCUA is also amending its regulation to address electronic advertisements. These amendments conform to the Electronic Signatures in Global and National Commerce Act (E-Sign Act).

DATES: This rule is effective June 21, 2001. To allow time for any necessary operational changes, however, the mandatory compliance date is October 1, 2001. Comments must be received on or before August 20, 2001.

ADDRESSES: Comments should be directed to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. You may also fax comments to (703) 518–6319 or e-mail comments to regcomments@ncua.gov. *Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION

A. Background

Part 707 of NCUA's regulations implements TISA. 12 CFR part 707. The purpose of part 707 and TISA is to assist members in making meaningful comparisons among accounts offered by credit unions and other financial institutions. Part 707 and TISA require, among other things, disclosure of yields, fees and other terms concerning share accounts to members at account opening, upon request, when changes in terms occur and in periodic statements. Many of these disclosures must be written.

In April 2001, The Board of Governors of the Federal Reserve System (Federal Reserve) issued an interim rule amending its Regulation DD, which implements TISA (April 2001 Interim Rule). That rule established uniform standards for the timing and electronic delivery of disclosures required by TISA and Regulation DD, and addressed electronic advertisements. 66 FR 17795 (April 4, 2001). The Federal Reserve has stated that electronic disclosures can effectively reduce compliance costs for financial institutions and allow them to provide Regulation DD disclosures to the consumer more efficiently without adversely affecting consumer protections. Under that rule, disclosures may be sent by e-mail to an electronic address designated by the consumer, or made available at another location, such as an Internet web site. If disclosures are not sent by e-mail, consumers must receive a notice informing them that they are available elsewhere. If posted to a web site, disclosures must be available for at least 90 days to allow consumers adequate time to access them. For disclosures that must be provided before account opening, consumers are required to access them before the account is opened. Under this rule, financial institutions must make a good faith attempt to redeliver electronic disclosures that are returned as undelivered, using the address information available in their files.

These amendments conform to the E-Sign Act. 15 U.S.C. 7001. The E-Sign Act was enacted in June 2000, to encourage the continued expansion of electronic commerce. It generally provides that electronic documents and signatures have the same validity as paper documents and handwritten signatures. It provides that consumer disclosures may be provided in electronic form only if the consumer affirmatively consents after receiving information specified in the statute. The consumer consent provisions in the E-Sign Act became effective October 1, 2000. Section 101(c)(5) of the E-Sign Act provides that consumers who gave consent prior to the effective date are not subject to those consent requirements.

In September 1999, before enactment of the E-Sign Act, the Federal Reserve issued an interim rule that also amended Regulation DD (September 1999 Interim Rule). 64 FR 49846 (September 14, 1999). With the issuance of the April 2001 Interim Rule, the Federal Reserve has withdrawn the September 1999 Interim Rule.

TISA requires NCUA to promulgate regulations substantially similar to those promulgated by the Federal Reserve within 90 days of the effective date of the Federal Reserve's rules. 12 U.S.C. 4311(b). In doing so, NCUA is to take into account the unique nature of credit unions and the limitations under which they may pay dividends on member accounts. In compliance with TISA, as discussed more fully below, NCUA is issuing this interim final rule with request for comments that is substantially similar to the Federal Reserve's April 2001 Interim Rule.

B. Interim Final Rule

The NCUA Board is issuing this rule as an interim final rule because there is a strong public interest in having in place consumer oriented rules that are consistent with those recently promulgated by the Federal Reserve. Additionally, as discussed above, NCUA is statutorily required to issue rules substantively similar to those of the Federal Reserve within 90 days of the effective date of the Federal Reserve's rules. Accordingly, for good cause, the Board finds that, pursuant to 5 U.S.C. 553(b)(3)(B), notice and public procedures are impracticable, unnecessary, and contrary to the public interest; and, pursuant to 5 U.S.C. 553(d)(3), the rule will be effective immediately and without 30 days advance notice of publication. Although the rule is being issued as an interim final rule and is effective immediately, the NCUA Board encourages interested parties to submit comments.

C. Section by Section Analysis

Section 707.3 General Disclosure Requirements

Section 707.3(a) is revised to reflect that the disclosures required by the newly created § 707.10 pertaining to electronic communications are subject to the same requirements as other disclosures required under part 707. Section 707.3(g) is added to provide a cross reference to other rules governing the electronic delivery of disclosures referenced in the newly created § 707.10.

Section 707.4(a)(1) Account Disclosures~~A~~Account-Opening

Credit unions must provide account-opening disclosures to members or potential members before an account is opened or a service is provided. Credit unions may delay delivering these disclosures if the member is not present when the account is opened or service is provided. This section provides that in such cases, account-opening disclosures must be mailed or delivered no later than 20 calendar days after the account is opened or the service is provided, whichever is earlier. The corresponding section in Regulation DD permits a 10-business day delay. NCUA amends this provision to conform to the Federal Reserve's time frame.

Furthermore, this section is amended to provide that credit unions may not delay delivering account-opening disclosures when an account is opened

by an ''electronic communication'' as defined in § 707.10. The Federal Reserve has determined that the difficulties in providing disclosures for accounts opened by mail or telephone are not present for accounts opened by electronic communication using visual text. As a result, required disclosures must be provided before an account is opened by an electronic communication. Neither TISA nor part 707 specifies when an account is considered opened. Credit unions may establish policies and procedures to address after-hours requests to open accounts to ensure that accurate disclosures are provided before the account is deemed opened by the credit union.

Section 707.4(a)(2) Account Disclosures~~-R~~equests

Section 707.4(a)(2)(i) is revised to require credit unions to mail or deliver disclosures in paper form or electronically to members or potential members who request them, but who are not present at the credit union when the request is made. The credit union has a reasonable time in which to do this. To provide disclosures electronically, the credit union must send the disclosures to the member's e-mail address, or send a notice alerting the member to the location of the disclosures, such as the credit union's web site.

Appendix C~~-S~~ection 707.4(a)(2)(i)~~-3~~—Timing for Response

Section 707.4(a)(2)(i) does not define what a ''reasonable time'' is for responding to requests for account information from members who are not present at the credit union at the time of the request. Section 707.4(a)(2)(i)–3 in Appendix C to part 707 is revised to provide that ten business days is a reasonable time for responding to these requests.

Appendix C~~-S~~ection 707.4(a)(2)(i)~~-4~~—Request by Electronic Communication

Section 707.4(a)(2)(i) permits credit unions to deliver requested disclosures electronically if the member provides an e-mail address where the disclosures may be sent. Section 707.4(a)(2)(i)–4 in Appendix C to part 707 is added to clarify that posting disclosures on a credit union's web site generally does not relieve the credit union's duty to provide disclosures upon request. If the member has provided an e-mail address, the credit union must either send the disclosures by e-mail or send a notice to the member pursuant to § 707.10(d)(2)(i) to inform the member where the disclosures are posted.

Section 707.6 Periodic Statement Disclosures

The E-Sign Act permits credit unions to provide disclosures to members using electronic communication, if the credit union complies with Section 101(c) of that statute. Section 101(c) of the E-Sign Act requires credit unions to provide specific information about the electronic delivery of disclosures and obtain the member's affirmative consent to receive electronic disclosures. As discussed more fully below, § 707.10(b) is adopted to set forth the general rule that credit unions may provide disclosures electronically only if the credit union complies with Section 101(c) of the E-Sign Act. This requirement applies to periodic statement disclosures.

After the Federal Reserve issued the September 1999 Interim Rule, NCUA amended § 707.6 by adding paragraph (c) to permit credit unions to deliver periodic statements electronically. 64 FR 66355 (November 26, 1999); 65 FR 21131 (April 20, 2000). With the adoption of § 707.10(b), however, § 707.6(c) is no longer current and is withdrawn.

Appendix C~~-S~~ection 707.8(a)—Misleading or Inaccurate Advertisements

Stating certain account terms in an advertisement for a deposit account triggers the disclosure of additional terms. If an advertisement using electronic communication displays a triggering term, such as ''bonus'' or ''annual percentage yield'', the advertisement must clearly refer the member to the location where the additional required information begins. For example, an advertisement that includes a bonus or annual percentage yield may be accompanied by a link in close proximity that directly takes the member to the additional information. Paragraph (9) is added to § 707.8(a) in Appendix C to part 707 to reflect this interpretation.

Appendix C~~-S~~ection 707.8(b)—Permissible Rates

Section 707.8(b) generally permits credit unions to state a dividend rate in addition to the annual percentage yield (APY), provided the dividend rate is stated in conjunction with, but not more conspicuously than, the APY. For advertisements using electronic communications, the member must be able to view both rates simultaneously. This requirement is not satisfied if the member can only view the APY by use of a link that connects the member to information appearing at another location. Paragraph (4) is added to § 707.8(b) in Appendix C to part 707 to reflect this interpretation.

Appendix C~~-S~~ection 707.8(e)(1)(i)—Exemption for Certain Advertisements

Section 707.8(e) exempts from some requirements advertisements made through broadcast or electronic media, such as television and radio or outdoor billboards. This exemption does not apply to electronic advertisements using electronic communication, such as Internet advertisements, because they do not have the same time and space constraints as other exempted advertisements. New paragraph (1) is added to § 707.8(e)(1)(i) in Appendix C to part 707 to reflect this interpretation.

Section 707.10(a) Electronic Communication

Electronic communication is defined as a message transmitted electronically between a credit union and a member in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor. Equipment is not limited to personal computers, provided the visual display used to deliver the disclosures meets the ''clear and conspicuous'' format requirement discussed below. Credit unions that accommodate vision-impaired members by providing disclosures that do not use visual text must also provide disclosures using visual text.

Section 707.10(b) General Rule

The E-Sign Act permits credit unions to provide disclosures using electronic communication, if the credit union complies with the consumer consent requirements in Section 101(c) of the E-Sign Act. Section 101(c) requires credit unions to provide specific information about the electronic delivery of disclosures before obtaining the member's affirmative consent to receive electronic disclosures.

The E-Sign Act does not affect any requirement imposed under TISA other than a provision that requires disclosures to be in paper form, nor does it affect the content or timing of disclosures. Electronic disclosures are subject to the format, timing and retainability rules and the clear and conspicuous standard of part 707. This guidance is reflected generally in § 707.10(b) in Appendix C to part 707.

Credit unions must provide electronic disclosures using a clear and conspicuous format. Also, in accordance with the E-Sign Act: (1) The credit union must disclose the requirements for accessing and retaining disclosures in that format; (2) the member must demonstrate the ability to access the information electronically and

affirmatively consent to electronic delivery; and (3) the credit union must provide the disclosures in accordance with the specified requirements. Except to the extent required by part 707, disclosures do not have to be provided separately from other information. Electronically delivered disclosures must comply with existing timing requirements under TISA and part 707. Consistent with rules for paper disclosures, disclosures provided periodically by e-mail are timely if sent by the required time. Disclosures posted at an Internet web site are timely if, by the required time, the credit union makes the disclosures available at that location and sends a notice alerting the member that the disclosures have been posted. This guidance is reflected in § 707.10(b)(3)(ii) in Appendix C to part 707.

When a credit union permits a member to open an account on-line, the member must be required to access disclosures required by § 707.4 before the account is opened. A link to the disclosures satisfies this timing rule if the member cannot bypass the disclosure before opening the account, or the disclosures must automatically appear on the screen, even if multiple screens are required to view the entire disclosure. It is not sufficient for credit unions to provide a bypassable navigational tool that gives members the option of receiving disclosures. This approach reduces the likelihood that members will actually receive the disclosures. This guidance is reflected in § 707.10(b)(3)(i) in Appendix C to part 707.

Disclosures required by TISA and part 707 to be in writing must also be in a form the member can retain. Electronic disclosures are subject to this same requirement. This guidance is reflected in § 707.10(b)(4) in Appendix C to part 707.

A credit union that controls the equipment providing electronic disclosures to a member, such as a computer terminal in the credit union's lobby or a public kiosk, must ensure that the equipment satisfies part 707's requirements to provide timely disclosures in a clear and conspicuous format and in a form that the member may keep. For example, if disclosures are required at the time of an on-line transaction, the disclosures must be sent to the member's e-mail address or must be posted at another location such as the credit union's web site, unless the credit union provides a printer that automatically prints the disclosures. This guidance is reflected in § 707.10(b)(5) in Appendix C to part 707.

Section 707.10(c) When Consent Is Required

Under the E-Sign Act, a member must give his affirmative consent to receive from the credit union electronic disclosures ''relating to a transaction'' that are required to be in writing by law or regulation. Section 707.10(c) provides that disclosures related to advertisements (§ 707.8) and those that are provided upon request (§ 707.4(a)(2)) are deemed not to be ''related to a transaction'' for purposes of this consent requirement.

Section 707.10(d)(1) Address or Location To Receive Electronic Communication.

Credit unions may deliver electronic disclosures to a member's e-mail address or make them available at another location such as a web site. If the credit union makes a disclosure available at such a location, it effectively delivers the disclosure by sending a notice alerting the member when the disclosure can be accessed and making it available for at least 90 days.

For purposes of § 707.10(d), a member's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by the credit union. This guidance is reflected in § 707.10(d) in Appendix C to part 707. An electronic address would not include systems that permit communication only between the member and the credit union, such as a home-banking program that allows a member to communicate directly with the credit union on-line with the use of a computer and modem. These systems, like a credit union's web site accessed via the Internet, give members access to account information at a location controlled by the credit union. In both instances, the credit union determines how long disclosures will be available to the member. Members who receive disclosures at their e-mail addresses, however, may choose when to review, and for how long to retain, account information. Members who receive disclosures by contacting a credit union's web site, however, also need to be alerted when the information is first available to ensure that they have the opportunity to access the information before it is removed. Accordingly, disclosures provided using systems such as home-banking programs are treated in the same manner as disclosures made available at a web site. They require a notice to alert the member when disclosures are posted and the notice must be sent by e-mail or to a postal address, at the credit union's option.

Section 707.10(d)(2)(i) Identifying the Account

Section 707.10(d)(2)(i) requires that the alert notice discussed above identify the account involved and the address or other location where the disclosure is available. Section 707.10(d)(2)-1 in Appendix C to part 707 provides guidance on the level of detail required in identifying the account.

Section 707.10(d)(2)(ii) 90-Day Rule

Section 707.10(d)(2)(ii) requires that disclosures provided at a web site must remain available for at least 90 days. This helps ensure that members have adequate time to access and retain a disclosure under a variety of circumstances, such as when a member may not be able for an extended period of time to access the information due to computer malfunctions, travel, or illness. The 90-day period is uniform for all disclosures, for ease of compliance. Section 707.10(d)(2)-2 in Appendix C to part 707 provides that while disclosures must be available for the entire 90-day period, the credit union has the discretion to determine whether they should be available at the same location for the entire period.

Section 707.10(d)(3) Exceptions

Section 707.10(d)(3) clarifies that the requirements of § 707.10(d)(2)(i) and (ii) do not apply to disclosures in certain advertisements (§ 707.8), and the requirements of § 707.10(d)(2)(ii) do not apply to disclosures made available upon a member's request(§ 707.4(a)).

Section 707.10(e) Redelivery

Part 707 does not require a credit union to verify that electronic disclosures it has sent were actually received by its members. The cost and burden of doing so would not be warranted. When electronic disclosures are returned undelivered, however, § 707.10(e) imposes a duty on the credit union to attempt redelivery (either electronically or to a postal address) based on information in the credit union's own files. Where a credit union actually knows that the delivery of an electronic disclosure did not take place, the credit union should take reasonable steps to effectuate delivery in some way. For example, if an e-mail message to a member containing an alert notice or other disclosure is returned as undeliverable, the credit union satisfies the redelivery requirement if it sends the disclosure to a different e-mail address or postal address that it has on file. Sending the disclosure a second

time to the same electronic address would not be sufficient if the credit union has a different address for the member on file. Section 707.10(e)-1 in Appendix C to part 707 provides this guidance.

This redelivery requirement is limited to instances where the electronic communication has not been delivered. It does not apply to instances where the disclosure is delivered but cannot be read by the member due to technical problems with the member's software. A credit union will have complied with timing requirements for sending a disclosure when the disclosure is initially sent in a timely manner, even though it is returned undelivered and the credit union is required to take reasonable steps to attempt redelivery.

Section 707.10(f) Entities Other Than a Credit Union

Section 707.10(f) provides that a person other than a credit union that is required to comply with part 707 may use electronic communication in accordance with the requirements of § 707.10, as applicable.

D. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact agency rulemaking may have on a substantial number of small credit unions. For purposes of this analysis, credit unions under $1 million in assets are considered small credit unions.

This interim final rule provides credit unions with the flexibility of using an optional and alternative method of delivering certain required disclosures. Credit unions are free to choose not to utilize this alternative. Credit unions that choose to use this alternative will likely realize a reduction in their costs of delivery as a result. The NCUA has determined and certifies that this interim final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that these amendments to part 707 do not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This interim final rule applies to all federally-insured credit unions, but does not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this interim final rule does not constitute a policy that has federalism implications for purposes of the executive order.

Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects 12 CFR Part 707

Advertising, Consumer protection, Credit unions, Reporting and recordkeeping requirements, Truth in savings.

By the National Credit Union Administration Board on June 14, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 722 and 742

Regulatory Flexibility Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board is issuing a final rule that will permit credit unions with advanced levels of net worth and consistently strong supervisory examination ratings to be exempt, in whole or in part, from certain NCUA regulations. The NCUA Board is also issuing a final amendment to the appraisal regulation to increase the dollar threshold from $100,000 to $250,000 for when an appraisal is required. This final rule and final amendment will reduce regulatory burden.

DATES: The rule is effective March 1, 2002.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Senior Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314 or telephone (703) 518–6540; or Lynn K. Markgraf, Program Officer, Office of Examination and Insurance, 1775 Duke Street, Alexandria, Virginia, or telephone (703) 518–6360.

SUPPLEMENTARY INFORMATION: On March 16, 2000, the NCUA Board issued an advance notice of proposed rulemaking (ANPR) on a regulatory flexibility and exemption (RegFlex) program with a sixty-day comment period. 65 FR 15275 (March 22, 2000). The Board received seventy-four comments on the RegFlex concept. After reviewing the issues addressed by the commenters, the Board issued a Notice of Proposed Rulemaking (NPR) on March 8, 2001. 66 FR 15055 (March 15, 2001). Although the Board actually received over 1400 letters or e-mail messages, NCUA staff credited multiple comment letters from the same credit union as one comment, for a total of 1304 comments on the proposed rule. Comments were received from 551 federal credit unions, 267 state-chartered credit unions, 438 credit union volunteers or members, 33 leagues, six national credit union trade associations, four realtors and associations, one bank trade association, one appraisal association, one insurance company, one law firm, and one construction company.

In general, 1297 commenters supported the proposed regulation and many commenters supported the proposal as written. Many supporters encourage the NCUA Board to provide further regulatory flexibility in the future. A number of commenters recommended some changes to the proposed rule. Many commenters commended the Board for its bold initiative and most of them believe this regulatory approach will reduce regulatory burden and provide greater flexibility for those credit unions that have demonstrated a track record of safe and sound operations.

Seventy-nine commenters believe that RegFlex credit unions will have a competitive advantage and fifty-eight of these commenters believe that well-managed credit unions deserve this advantage. Thirty-six commenters stated that RegFlex credit unions would not have a competitive advantage.

Regarding risk to the National Credit Union Share Insurance Fund (NCUSIF), 184 commenters stated that the adoption of this proposal will not significantly increase risk. Most of these commenters believe no increase in risk will occur because healthy credit unions have the ability to manage any increased safety and soundness concerns. Two commenters believe the proposal will increase risk. Many commenters believe the regulation will encourage credit unions to become stronger financial institutions.

Discussion

RegFlex Criteria

The first criterion for eligibility under this proposal, is that credit unions must have received a composite CAMEL code 1 or code 2 for two consecutive exams. The second criterion is that a credit union must have a net worth ratio of nine percent or greater, and be well-capitalized under NCUA's prompt corrective action regulations. 12 CFR Part 702. The NCUA Board believed the proposed criteria were generally sound and did not propose that a CAMEL 1 or 2 in management needs to be part of the criteria. One hundred and five commenters specifically supported the eligibility requirements as proposed. Twenty-two commenters specifically agreed with the NCUA Board that there should not be a separate management component for RegFlex eligibility. A few commenters stated that a credit union should have a 1 or 2 in management to be eligible for RegFlex.

A few commenters suggested different eligibility requirements to obtain the benefits of RegFlex. One of these commenters requested the Board not only look at the net worth and CAMEL ratings of credit unions, but also look to how well they are serving their members and whether those members are satisfied. Almost all of the other commenters' suggestions retained some of the Board's proposal of either a CAMEL component or net worth ratios. While the Board agrees that service to members and member satisfaction are important issues for credit unions, these are not generally considered to be safety and soundness issues, and would not be easily measured criteria for purposes of RegFlex. The Board continues to believe that CAMEL ratings and net worth ratios are the best measures of how well a credit union is managed and how much risk it presents to the NCUSIF and the credit union system. That is, consistent with safety and soundness concerns, credit unions with advanced levels of net worth and consistently strong supervisory examination ratings have earned exemptions from certain NCUA Regulations.

CAMEL Rating

Thirty-two commenters stated that CAMEL ratings should not be used to determine eligibility because they can be used unfairly by examiners to keep credit unions out of the program. Many of these commenters believe that the CAMEL rating is arbitrary and subjective to the individual examiner. Three commenters suggested a different time period for maintaining the CAMEL component. Thirteen commenters suggested using call report data and financial statements instead of a CAMEL rating. As discussed above, the Board is retaining the requirement that a credit union must have received a composite CAMEL code 1 or code 2 for two consecutive exams. The Board understands the commenters' concerns that a credit union may be unfairly kept out of the program. However, the application process should help alleviate some of these concerns because a credit union that lacks the required CAMEL rating can still apply to be part of the program if it has sufficient net worth. In addition, if credit union management believes its CAMEL rating is being manipulated, it should ask the regional director to review the issue.

Net Worth Requirement

Regarding the net worth requirement, 485 commenters believe the nine percent net worth requirement should be decreased. Four hundred and fifty-six of these commenters stated the net worth requirement should be seven percent and sixteen of these commenters stated that the net worth requirement should be eight percent. The remaining commenters offered varying numbers. As discussed above, the Board is retaining the requirement that a credit union must have a net worth ratio of nine percent or greater,

and be well-capitalized under NCUA's prompt corrective action regulations. The ability to build capital, which is demonstrated by the cushion of 200 basis points, represents a significant decrease in risk to both the credit union and the NCUSIF. Some of the reasons for this 200 basis point cushion are to minimize the risk of engaging in the expanded authority permitted by the RegFlex program as well as to minimize PCA implications. The Board continues to believe that the 200 basis point margin provides a sufficient margin of safety for RegFlex credit unions to withstand unexpected events and normal business fluctuations.

Net Worth Requirement for Complex Credit Unions

The NCUA Board proposed a different net worth requirement for complex credit unions: Nine percent or 200 basis points over their risk based net worth (RBNW) requirements, whichever is greater. This net worth requirement is beyond the ''well-capitalized'' threshold established by prompt corrective action (PCA). The NCUA Board stated that a significant margin of safety for complex credit unions is afforded by net worth ratios exceeding general requirements, especially when combined with stable, high CAMEL ratings.

Thirty-two commenters approved of the higher standard for ''complex'' credit unions. Nineteen commenters stated that the trigger should be the same for all types of credit unions. Three commenters stated that a credit union that is 200 basis points over its net worth requirement for PCA should qualify for RegFlex, even if they do not have nine percent net worth. A few commenters suggested that the alternative measure for complex credit unions should be deleted. A few other commenters suggested different triggers for complex credit unions. One commenter stated that examiners should determine the net worth requirement for the purpose of RegFlex eligibility.

The Board continues to believe that a 200 basis point margin over the minimum level required of a non-complex credit union will provide a sufficient, but not excessive, safety cushion to keep credit unions from ''bouncing'' in and out of RegFlex eligibility. Credit unions that meet the definition of ''complex'' under PCA do so because of additional balance sheet risk. In order to provide the safety cushion and risk mitigation RegFlex contemplates, a higher net worth level is needed. Again, as with non-complex credit unions, a 200 basis point cushion over the minimum level for a complex credit union to be classified as well-capitalized is considered to be a sufficient safety cushion to keep these credit union from ''bouncing'' in and out of RegFlex eligibility.

The NCUA Board has made some minor modifications in the language in the final rule in §§ 742.1 and 742.2 to make it consistent with the language in NCUA's prompt corrective action regulations.

RegFlex Process

The NCUA Board proposed an automatic exemption for credit unions meeting the eligibility requirements. The Board noted that, as credit unions become eligible for RegFlex, NCUA will notify credit unions of their eligibility, generally, during the examination process. Four hundred and sixty-one commenters believe the exemption should be automatic for credit unions that qualify, just as the Board proposed. A few commenters believe approval should be automatic with a notification to NCUA by the credit union. A few commenters stated that the process should not be automatic and that the credit union should apply to NCUA for approval. The NCUA Board believes that an automatic exemption is consistent with the spirit of the RegFlex concept and will not require any application for these credit unions meeting the criteria. As credit unions become eligible for RegFlex, NCUA will notify credit unions of their eligibility, generally, during the examination process.

The NCUA Board also proposed an application process for credit unions that meet only one of the two stated criteria to allow more credit unions to have RegFlex authority while maintaining the safety and soundness considerations that are fundamental to the program. The NCUA Board proposed that if a credit union is a CAMEL 3 (or CAMEL 1 or 2 for less than two consecutive cycles) with a net worth in excess of nine percent or if the credit union is a CAMEL 1 or 2 with a net worth under nine percent (or if complex, its risk based net worth level is lower than nine percent or 200 basis points over their risk based net worth requirements), a credit union can apply to the regional director for a RegFlex designation.

Twenty-five commenters supported an application process for credit unions that meet only one of the two eligibility criteria. A few of these commenters would only allow credit unions that meet the CAMEL criteria to use the application process. These commenters believe that the CAMEL component is a better indicator of safety and soundness than the net worth criteria. Two commenters did not support the application process. A number of commenters that addressed this issue requested that the rule state the criteria the regional director will consider when making this determination.

The NCUA Board continues to believe that the RegFlex authority should be extended to as many credit unions as possible while maintaining the safety and soundness considerations that are fundamental to the program. Therefore, the NCUA Board is retaining in the final rule the application process described above. The regional director will review the application in relation to the criteria that was not met for RegFlex, that is, net worth level or safety and soundness issues that resulted in a lower CAMEL rating. In the case of a credit union not meeting the new worth level, the regional director will review past, present and projected future performance, from both a managerial and financial perspective, to determine RegFlex approval. For those credit unions that meet net worth levels but not CAMEL rating requirements, the regional director's review will focus on the magnitude and resolution of the issues that resulted in the lower CAMEL rating.

The proposal stated that a regional director, in his or her sole discretion, for substantive and documented safety and soundness reasons, would be able to revoke the RegFlex authority in whole or in part at any time and without advance notice. In such cases, a credit union would be able to appeal the determination to NCUA's Supervisory Review Committee within 60 days of the regional director's determination. One hundred and seven commenters support the regional directors' ability to revoke a RegFlex designation. A few of these commenters suggested allowing a grace period for a credit union if it has minimal deviation from the eligibility requirements for one or more periods. If a credit union falls below the net worth eligibility requirements for a projected short period of time, the credit union should apply for a ''grace period'' and the regional director will make a determination on whether to revoke, in whole or in part, the RegFlex authority. The regional director will review the continued RegFlex eligibility in the same manner as stated above for the application process. Assessing the issues that cause the deviation will eliminate credit unions operating near the minimum net worth requirements from making multiple requests to continue RegFlex activities. If a credit union's CAMEL rating is lowered so that the credit union meets neither eligibility

requirement, the regional director will revoke the RegFlex designation.

Sixty-four commenters do not approve of the regional director having sole discretion to revoke a RegFlex designation. A few commenters believe that a regional director should only have the authority to revoke a designation if a credit union no longer meets the RegFlex eligibility criteria. A few commenters suggested that only the central office should be able to revoke the RegFlex designation. The NCUA Board believes a regional director's authority to revoke the exemption is integral to success of the program. External events, as well as internal events, can produce a dramatic change in a credit union's financial condition in a matter of months. The regional director should have the discretion to act quickly in regard to RegFlex eligibility to maintain the financial health of a credit union when certain events or trends exist. The Board also believes that the regional director will be able to make a more informed and expedited decision than central office staff. Therefore, the final rule retains the ability of the regional director to revoke the RegFlex designation.

Most of the commenters, whether for or against the regional directors' discretion, support the proposed rule's requirement that the regional director first notify the credit union of the revocation and provide the credit union with appeal rights. The NCUA Board is retaining the appeal process outlined in the proposed rule. NCUA is in the process of revising IRPS 95–1 on the Supervisory Review Committee to include RegFlex issues as an appeal that the Committee is authorized to address.

Five commenters agreed with the NCUA Board that, if a credit union loses RegFlex eligibility, its past actions will be grandfathered. Therefore, the NCUA Board is retaining in the final rule the express statement that, if a credit union loses its RegFlex eligibility, its past actions are grandfathered and no divesture is required. However, this does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

(1) Section 701.36—FCU Ownership of Fixed Assets

The NCUA Board proposed including sections of the fixed asset rule, including the five percent limitation, in the RegFlex rule. In the proposal, the NCUA Board encouraged, but did not require, that a RegFlex credit union incorporate into its business plan the fixed asset limit it plans to establish. Four hundred and fifty-one commenters supported the Board's inclusion of the fixed asset rule in RegFlex. Many of these commenters stated a credit union's board of directors should set the fixed asset limit. Fifteen commenters stated that all credit unions should be exempt from the fixed asset rule. Three commenters did not believe the fixed asset rule should be part of RegFlex. A few commenters requested that RegFlex credit unions be exempt from all provisions of the fixed asset rule. The NCUA Board believes the 5% limitation on fixed assets should be eliminated for credit unions that qualify for RegFlex. However, the NCUA Board encourages the board of directors of each RegFlex credit union to establish a fixed asset limitation and incorporate that limit into its written business plan.

While the NCUA Board noted that an exemption from some of the restrictions on purchasing a building and leasing a portion of the property would also be lifted under RegFlex, it stated this would not authorize a credit union to engage in long-term commercial leasing. For safety and soundness and legal reasons, the NCUA Board stated that a credit union still must comply with § 701.36(d) of the fixed asset rule and have a plan to use the property for its own operation. Seven commenters specifically endorsed federal credit unions complying with § 701.36(d). Thirty-five commenters would exempt RegFlex credit unions from this section. However, for legal and safety and soundness reasons, the Board believes that RegFlex credit unions should abide by this provision and have a plan to use the property for its own operation because federal credit unions do not generally have the authority to engage in commercial leasing. One commenter stated that NCUA should expand § 701.36(d) from a three-year to a five-year period for partial utilization of real property for RegFlex credit unions. The agency is evaluating this suggestion and may consider such an expansion when the fixed asset rule is next reviewed and revised.

The NCUA Board stated in the preamble to the proposed rule that RegFlex credit unions should also comply with the conflict of interest provision in § 701.36(e) of the rule. The Board stated that this conflict of interest provision is sound, consistent with the Federal Credit Union Bylaws, and already offers more flexibility than other conflict of interest provisions in NCUA's regulations. Only two commenters addressed this issue and approved of RegFlex credit unions continuing to follow the conflict of interest section of the fixed asset rule. The NCUA Board is retaining in the final rule that RegFlex credit unions comply with the conflict of interest provision in the fixed asset rule.

Finally, the NCUA Board requested comment on whether the fixed asset rule, itself, should be structured differently so that there would be a tiered limit on fixed assets. A few commenters requested more flexibility on the limit in the fixed asset rule. Seventeen commenters supported a tiered structure based on a percentage of net worth. Two commenters opposed a tiered structure. A few commenters provided different methods for calculating a fixed asset limit. The NCUA Board is committed to revising the fixed asset rule and will consider the use of some type of a tiered structure, such as the one used by the Office of Thrift Supervision, when the rule is revised.

(2) Part 703—Investment and Deposit Activities

The NCUA Board proposed lifting certain investment requirements for RegFlex eligible credit unions. Three hundred and one commenters supported including the proposed sections of the investment rule in RegFlex. Eight of these supporters stated that NCUA needed to reduce investment requirements further for those credit unions with acceptable capital ratio levels. A few commenters believe other provisions of the investment regulation should be considered, but they did not make specific recommendations. One commenter believes that the investment changes should apply to all credit unions.

In response to these comments, the NCUA Board directed the Office of Investment Services and the Office of Examination and Insurance to review part 703 to determine if regulatory relief can be provided to all credit unions in the context of amending part 703. As a result of this review, the NCUA Board issued an Advanced Notice of Proposed Rulemaking (ANPR) in October of this year, requesting comment from credit unions on expanding selected sections of part 703.

One commenter believes RegFlex credit unions should be able to make any investments that banks may. Federal credit unions do not have the same statutory investment authority as banks so the Board cannot adopt this suggestion. *See* 12 U.S.C. 1757(15). One commenter would not include the investment regulation in RegFlex because the commenter perceived an increase in risk. Three commenters stated they did not approve of expanding investment powers. The NCUA Board recognizes these concerns

but believes institutions meeting the RegFlex criteria can manage the additional risk.

Section 703.90(c) requires quarterly stress testing (300 basis point shock) of individual complex securities if the total sum of complex securities, as defined by the investment regulation, exceeds net capital. For those credit unions that measure the impact of interest rate changes on their entire balance sheet as part of their asset liability management programs, the NCUA Board proposed waiving this regulatory requirement for RegFlex credit unions. The NCUA Board also stated that RegFlex credit unions should continue to measure, at least quarterly, the impact of a sustained, parallel shift in interest rates of plus and minus 300 basis points on their entire balance sheet as part of their asset liability management monitoring. Fifty-nine commenters would waive the 300 point basis point shock test for RegFlex credit unions. Twelve commenters opposed waiving the quarterly stress testing for RegFlex credit unions. The NCUA Board has decided to include this investment provision in the final regulation because it does not pose a significant adverse effect for RegFlex credit unions. This exemption does not eliminate stress testing, rather it reduces duplicative reporting burden for those institutions that have a risk management process that measures the impact of interest rate changes on the entire balance sheet.

Section 703.40(c)(6) limits the discretionary delegation of investments to third parties to 100% of net capital. NCUA proposed waiving the 100% limitation and permitting RegFlex credit unions to set their own limit in a policy adopted by their boards of directors. Eighty-seven commenters believe it is appropriate for NCUA to waive or modify the 100% limitation on discretionary delegation of investments and allow the credit union to set a limit via board policy. Five commenters did not support waiving the 100% limitation on discretionary delegation of investments for RegFlex eligible credit unions. The NCUA Board has decided to include this investment provision in the final regulation because it offers expanded investment portfolio management options for RegFlex institutions and it would not have a significant adverse impact on safety and soundness.

Section 703.110(d) limits zero coupon investments to under ten years from settlement date. The NCUA Board proposed removing this limitation for RegFlex credit unions. Twelve commenters specifically supported the exemption; seven commenters specifically did not. The NCUA Board has decided to include this investment provision in the final regulation because it would not have a significant adverse impact on safety and soundness and would increase potential yield when part of a managed ALM.

The NCUA Board had previously decided not to include § 703.110, which prohibits stripped, mortgage-backed securities, residual interests in CMOs/REMICS, mortgage servicing tights, commercial mortgage-related securities, or small business related securities. Nevertheless, a number of commenters discussed this section. Thirty-two commenters stated NCUA should permit RegFlex credit unions to make these type of investments. Thirteen commenters believe stripped mortgage-backed securities and residual interests in CMOs/REMICs are not viable investments for credit unions. Twelve commenters stated these are high risk investments and suggested that perhaps a percentage of total investment could be allowed if credit unions measure risk adequately. Because of the risk associated with these types of investments, the NCUA Board has decided not to incorporate it into the final regulation. However, as discussed earlier, comments on these investment activities are requested in the ANPR on part 703.

Five commenters requested investments in commercial paper for RegFlex credit unions. One commenter would permit natural person credit unions the same investment powers as corporate credit unions. One commenter believes NCUA should allow credit unions to purchase principal-only stripped mortgage-based securities to hedge interest rate risk as the value of the security moves positively to a rate increase. Section 120(a) of the Federal Credit Union Act authorizes the NCUA Board to provide expanded investment authority for corporate credit unions by regulation. This statutory flexibility does not exist for natural person credit unions. The ANPR on part 703 requested comments on authorizing principal-only strips as a vehicle to hedge interest rate risk.

(3) Section 701.25—Charitable Donations

The current rule limits recipients of charitable donations to organizations located in or conducting activities in a community in which the federal credit union has a place of business. Furthermore, the board of directors must approve charitable contributions, and the approval must be based on a determination by the board of directors that the contributions are in the best interests of the federal credit union and are reasonable given the size and financial condition of the federal credit union. The NCUA Board asked whether credit unions meeting the RegFlex criteria should be completely exempt from the requirements of this regulation. Eighty-three commenters stated that the entire charitable donations regulation should be part of RegFlex. One hundred and forty-four commenters believe the charitable donations regulation should be eliminated for all federal credit unions. Three commenters would not include charitable donations as part of RegFlex.

The NCUA Board is convinced that credit unions qualifying for RegFlex have proven their track record of sound management and should be exempt from the charitable donations regulation. However, the Board is not convinced that this exemption should apply to all credit unions. The donation of a credit union's members' money to an outside party is a highly sensitive issue. The Board believes the requirements in the current regulation are critical for nonqualifying credit unions to ensure that the interests of the credit union's members are protected and that conflicts of interest are avoided.

(4) Sections 701.32(b) and (c)—Payment on Shares by Public Unit and Nonmembers

The current regulation limits the maximum amount of all public unit and nonmember shares to 20% of total shares of a federal credit union or $1.5 million, whichever is greater. The NCUA Board proposed that these provisions be part of the RegFlex rule. Two hundred and six commenters supported including the proposed provisions on public unit and nonmember accounts in the final rule. Seven commenters would not include these provisions as part of RegFlex. Eight commenters stated that low-income credit unions should be exempt from the limits on nonmember shares. One commenter stated that RegFlex credit unions should be exempt from all of the provisions of § 701.32. Twenty-one commenters stated this exemption should apply to all credit unions.

A number of commenters stated this regulation is unnecessary because of PCA. While PCA may serve to discourage excessively rapid asset growth in a credit union, it does not mitigate the additional risks that may be presented by nonmember shares. These accounts frequently are attracted by offering higher than normal dividend rates and are characteristically more volatile than core member shares. This

additional volatility can pose asset-liability management concerns and liquidity concerns. The NCUA Board has not been provided any convincing rational for exempting all federal credit unions from these provisions and has incorporated it in the final rule.

Two commenters stated this provision should also apply to state-chartered credit unions due to the language in § 741.204. The NCUA Board agrees with this comment. If a state-chartered credit union meets the RegFlex criteria, then the credit union need not comply with § 701.32(b) and (c). A state-chartered credit union that only meets one of the two criteria may also avail itself of the application process.

(5) Section 701.23—Purchase, Sale and Pledge of Eligible Obligations

The NCUA Board requested comment on whether to permit credit unions that meet the RegFlex criteria to purchase any auto loan, credit card loan, member business loan, student loan, or mortgage loan from any other credit union as long as they are loans the purchasing credit union is empowered to grant. The only limitation to this authority is the statutory limitation regarding the purchase of eligible obligations from liquidating credit unions. One hundred and sixty-three commenters supported expanding the authority for the purchase and sale of eligible obligations. Some of the commenters believe this provision would help the safety and soundness of the credit union system. Seven commenters suggested this section apply to all federal credit unions.

One commenter stated that, due to the NCUSIF nexus in § 741.8, state-chartered credit unions must also be granted this additional authority. The NCUA Board is cognizant that it failed to state clearly that RegFlex credit unions may purchase eligible obligations from federally insured credit unions. The final rule has been amended to make this distinction clear. Section 741.8 does not preempt a state's rule that grants the same authority as this RegFlex provision.

One commenter recommended that credit unions be able to purchase member loans from other financial institutions and business entities but was not able to provide a compelling legal basis for this extension of authority. One commenter objected to the inclusion of this section and stated that allowing federal credit unions to hold these loans in their portfolio is contrary to NCUA's historical position. The authority for this provision is in section 107(14) of the Federal Credit Union Act. The legal analysis for including this provision in RegFlex was addressed in the preamble to the proposed rule and need not be repeated here. 66 FR 15055, 15059 (March 15, 2001). The NCUA Board believes this authority expands the liquidity options for credit unions and enhances the safety and soundness of the credit union system. Therefore, the NCUA Board is incorporating this authority into the final regulation, with the only limitation being the statutory limitation regarding the purchase of eligible obligation from liquidating credit unions.

Comments on Other Regulations

The NCUA Board requested comment on whether any other regulation should be part of the RegFlex program. Numerous comments were received on various regulations, most of which the Board previously stated would not be part of RegFlex or are statutorily required.

Mortgage Lending—Section 701.21(f) and (g)

One hundred and seventy commenters recommended easing regulatory limits or ''examiner guidelines'' limiting mortgage lending for RegFlex credit unions. These commenters mistakenly believe there are examiner guidelines or a regulatory limit on how many mortgages a credit union may make. Five commenters asked that mortgage lending be liberalized, but did not specify how this should be accomplished. The agency will continue to review its mortgage lending regulation to determine if it can reduce regulatory burden. One hundred and one commenters requested that RegFlex credit unions be exempt from loan maturity limits. One commenter suggested that RegFlex credit unions have 30 years to finance the purchase of vacation or rental properties. One commenter believes RegFlex credit unions should have a 30-year maturity on home improvement and home equity loans. Most of NCUA's loan maturity limits are statutory but the agency will continue to review § 701.21(f) to determine if there is a need to expand the 20-year maturity limit for those specified types of loans.

Leasing—Part 714

In the proposal, the NCUA Board stated that the leasing regulation is not currently a good candidate for RegFlex because of safety and soundness concerns. In any case, seventy-four commenters recommended including the leasing regulation as part of RegFlex, but did not specify whether it should include the whole regulation or simply certain provisions. Six commenters requested an exemption from the 25% residual interest requirement imposed by § 714.4. Five commenters would not include leasing in RegFlex. One commenter requested that NCUA exempt all credit unions from the leasing regulation. The NCUA Board is not persuaded that the leasing regulation should be part of RegFlex. The NCUA Board has safety and soundness concerns regarding leasing and has not been provided any convincing rationale on why the leasing regulation is unduly burdensome.

Incidental Powers—Part 721

The NCUA Board stated that it did not believe the new incidental powers activities regulation should be part of RegFlex. Six commenters stated that RegFlex credit unions should have greater latitude with their incidental powers. One commenter stated that incidental powers should not be part of RegFlex. The NCUA Board issued a final rule on incidental powers in July that expands a credit union's incidental powers activities and is applicable to all federal credit unions.

Interest Rate Ceiling—Section 701.21(c)(7)

One commenter requested that the NCUA Board increase the interest rate ceiling for RegFlex credit unions. NCUA is statutorily required to review its interest rate ceiling every 18 months if the ceiling is above 15%. The NCUA Board does not believe RegFlex credit unions should have a higher interest rate ceiling than the current 18%.

CUSO Regulation—Part 712

One commenter recommended that NCUA should exempt RegFlex credit unions from unspecified provisions of the CUSO regulation. The NCUA Board is not including the regulation in RegFlex because it was updated in July of this year and it received no specific recommendation. The Board wishes to note that the 1% investment and lending limits are statutory. *See* 12 U.S.C. 1757(5)(D) and (7)(I).

Member Business Loans—Part 723

One commenter recommended that NCUA exclude the member business loan regulation from RegFlex. Thirty-four commenters requested exemptions from member business loan requirements that are not statutory in nature. Seven other commenters requested more flexibility in member business loans. Seventy commenters stated RegFlex credit unions should be exempt from the loan-to-value requirements in the member business loan regulation. One commenter

requested an exemption from the staff experience requirement in the member business loan regulation. Four commenters would lift the statutory cap on member business loans for RegFlex credit unions. Two commenters requested that RegFlex credit unions have the ability to offer unsecured business loans that are not credit cards or lines of credit up to a present limit of $50,000. One commenter requested the amount of the aggregate loan limit on business loans to one individual or group should be increased to 25% of net worth for RegFlex credit unions. The NCUA Board does not believe the member business loan regulation is a good candidate for RegFlex because of statutory requirements and safety and soundness concerns. *See* 12 U.S.C. 1757a. However, as a part of the agency's ongoing regulatory review process, the entire member business regulation is scheduled for review in 2003. The NCUA Board will continue with its efforts to reduce, where appropriate, regulatory burden.

Fidelity Bond Coverage—Part 713

Four commenters stated RegFlex credit unions should be exempt from unidentified provisions of part 713 on fidelity bond coverage. The NCUA Board believes this regulation is minimally burdensome for credit unions and, due to safety and soundness concerns, will not be part of RegFlex.

Field of Membership Issues

In the proposal, the NCUA Board stated that field of membership issues should not be part of RegFlex. Nevertheless, numerous commenters addressed this issue. Sixteen commenters did not believe field of membership issues should be part of RegFlex. One commenter stated field of membership issues should be part of RegFlex.

One hundred and forty-eight commenters supported freezing the asset base for purposes of calculating the operating fee as an incentive for expanding into the low-income area. Four commenters disagreed with this provision being part of RegFlex. One hundred and twenty commenters supported the use of incentives to encourage credit unions to expand into low-income or underserved communities. Four commenters did not approve of any incentives for credit unions to add underserved areas.

Last year, the NCUA Board issued final amendments to NCUA's Chartering Manual that addressed the addition of underserved areas. Although the NCUA Board deferred any action regarding incentives, it did streamline the application process. As a result, over one hundred and twenty-seven federal credit unions have added underserved areas this year. It appears that no incentives are warranted since credit unions are rapidly expanding into underserved areas. The Board will continue to monitor this issue and, if the increase in service to underserved areas begins to diminish significantly, it will review the issue again.

Examination Issues

Although the NCUA Board did not request comment on changes to NCUA's supervision and examination program for credit unions meeting the RegFlex criteria, many commenters addressed this issue. Five hundred and one commenters stated that a different exam cycle or more favorable examination treatment should be offered to RegFlex credit unions. Many of these commenters requested a streamlined examination process for RegFlex credit unions. Most of these commenters suggested an 18 to 24 month cycle. Many of these commenters also stated that outside auditors should perform audits in lieu of on-site examinations to save time and avoid duplication. Three commenters stated that RegFlex credit unions should not have more favorable treatment than other credit unions. The NCUA Board recently adopted a risk-based examination scheduling policy, that will result in many credit unions being examined twice over a three-year period. The agency's intent is to move toward a more risk-focused examination approach to place greater reliance on outside audits. This approach, however, will not relieve NCUA of its responsibility to evaluate safety and soundness. The role of an audit is to evaluate the adequacy of internal controls and to attest to the fairness of financial statement presentation, but not to evaluate risk to the NCUSIF. The NCUA Board will continue to review the examination process to determine if it can be further streamlined and improved.

Four commenters suggested that NCUA should revise peer comparisons for RegFlex credit unions. Four other commenters stated that NCUA should eliminate peer comparisons for RegFlex credit unions. Two commenters were not in favor of eliminating peer comparisons and do not believe that delinquency and charge-off ratios should be less important to examiners. NCUA provides peer comparisons primarily for use by credit union management. Generally, the agency finds that credit unions appreciate receiving this information and, in fact, some have requested that NCUA provide a more detailed presentation of the data. The peer information is used by NCUA examiners as a frame of reference, rather than a determination of a CAMEL rating. Two commenters requested more flexibility on delinquency and charge-offs for RegFlex credit unions. One commenter perceives a tendency for examiners to recommend that credit unions develop written policy statements to replace current documented operating procedures. Since these comments primarily relate to examination issues affecting all credit unions, they will be addressed separately from this rule. NCUA is currently reviewing these issues and may incorporate some of these ideas in the revised examiners guide.

Prompt Corrective Action—Part 702

One hundred and fifty-three commenters believe NCUA should grant RegFlex credit unions more favorable treatment under PCA. The basic net worth criteria contained in the PCA were established by Congress, and NCUA does not have the ability to change them. More importantly, to be eligible for RegFlex, a credit union's net worth must exceed, by 200 basis points, the minimum level for it to be well capitalized under PCA. By virtue of being well capitalized, the credit union is not affected by PCA, and there is no more favorable treatment that could be offered under PCA.

State Charters

Twenty-two commenters stated that NCUA should expand the rules to make RegFlex applicable to state-chartered credit unions. The NCUA Board recognizes and is committed to the dual chartering system. Likewise, as the regulator of federal credit unions, the NCUA Board is committed to reducing regulatory burden, where appropriate, on federal credit unions. On those occasions when a regulation applies to state-chartered credit the NCUA Board will expand RegFlex to them.

Section 722.3(a)(1)—Proposed Amendment to the Appraisal Regulation

NCUA's current appraisal regulation is more restrictive than the regulations of other financial institution regulators. Because experience has demonstrated that most credit unions are able to manage a higher degree of risk in making loans without an appraisal, the NCUA Board proposed an amendment to § 722.3(a)(2) to increase the threshold for an appraisal from $100,000 to $250,000. The NCUA Board also proposed to increase the threshold for an appraisal for a member business loan to $250,000 if it involves real estate. The

increase would be consistent with the regulatory provisions of the agencies regulating banks and thrifts. Two hundred and eighty-two commenters fully supported the proposed dollar threshold for an appraisal. Twenty commenters objected to increasing the appraisal threshold. One commenter opposed increasing the threshold for business lending because this commenter believes this type of lending is riskier. One commenter suggested that NCUA modernize appraisal requirements for agricultural lending.

The NCUA Board has not been persuaded that the increase in the appraisal threshold would significantly increase safety and soundness concerns so the proposed amendment is adopted in the final rule. Credit unions must still make reasonable determinations of value to ensure compliance with loan-to-value requirements. Section 722.3(d) of the appraisal rule requires that a real estate related transaction under the dollar threshold be supported by a written estimate of market value performed by an independent, qualified, and experienced individual. In addition, § 722.3(e) allows NCUA to require an appraisal whenever necessary to address safety and soundness concerns. These two sections of the appraisal rule mitigate any potential safety and soundness concerns raised by increasing the dollar threshold.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small entities (primarily those under $1 million in assets). The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. The reason for this determination is that the final rule reduces regulatory burden. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

Paperwork Reduction Act

The application requirements in part 742 have been submitted to the Office of Management and Budget. Under the Paperwork Reduction Act of 1995, no person is required to respond to a collection of information unless it displays a valid OMB Number. The control number will be displayed in the table at 12 CFR part 795.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. One section of this final rule will lift a regulatory requirement for some federally-insured state-chartered credit unions. However, this final rule will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act of 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 26821 (1998).

List of Subjects

12 CFR Part 722

Credit unions, Mortgages, Reporting and recordkeeping requirements.

12 CFR Part 742

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on November 15, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 700, 701, 712, 715, 723, 725, and 790

Definitions; Organization and Operation of Federal Credit Unions; Credit Union Service Corporations; Supervisory Committee Audits and Verifications; Member Business Loans; Central Liquidity Facility; Description of NCUA

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is issuing a final rule to amend various rules to make technical corrections and add and revise certain definitions. The Board is adding a scope section and definitions of ''paid-in and unimpaired capital and surplus'' and ''unimpaired capital and surplus'' to its rule containing definitions. The Board also is removing obsolete references from this rule and updating the rule concerning changes in officials of newly chartered or troubled credit unions. The Board is correcting a citation in the supervisory committee rule and making clarifications to the credit union service organization (CUSO) rule and the member business loan rule. In addition, the Board is updating and clarifying the definition for ''paid-in and unimpaired capital and surplus'' in the Central Liquidity Facility (CLF) rule. Finally, the Board is changing a reference in Part 790 from the ''Office of Community Development Credit Unions'' to the ''Office of Credit Union Development.''

DATES: This rule is effective January 22, 2002.

FOR FURTHER INFORMATION CONTACT: Regina Metz, Staff Attorney, Division of Operations, Office of General Counsel, at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428, or telephone: (703) 518–6561; or Herbert S. Yolles, Deputy Director, Office of Examination and Insurance, at the same address or telephone: (703) 518–6360.

SUPPLEMENTARY INFORMATION:

Background

On June 21, 2001, NCUA issued a proposed rule on definitions and technical corrections. 66 FR 33211, June 21, 2001. The proposed rule resulted from NCUA's policy of continually reviewing its regulations to ''update, clarify and simplify existing regulations and eliminate redundant and unnecessary provisions.'' Interpretive Rulings and Policy Statement (IRPS) 87–2, Developing and Reviewing Government Regulations. The NCUA Board is issuing the final rule unchanged from the proposed rule.

The proposed rule replaced obsolete references in two parts of NCUA's regulations related with new references to prompt corrective action, section 216 of the Federal Credit Union Act. 12 CFR 700.1, 701.14. In the definitions part of the regulations, the proposed rule added a scope section and definitions for ''paid-in and unimpaired capital and surplus'' and ''unimpaired capital and surplus.'' 12 CFR part 700. The proposed rule conformed definitions of paid-in and unimpaired capital and surplus in the CUSO and CLF rules to the proposed definitions in the definitions part. 12 CFR 712.2(d); 12 CFR 725.2(o). The proposed rule also corrected a citation in the supervisory committee audit rule and clarified the member business loan rule by changing a reference from ''federally insured credit unions'' to ''federally insured state-chartered credit unions.'' 12 CFR 715.2(l), 723.4. The proposed rule also updated NCUA's regulations by changing a reference in Part 790 from the ''Office of Community Development Credit Unions'' to the office's new name, the ''Office of Credit Union Development.'' The NCUA Board is adopting all the proposed changes in the final rule.

Summary of Comments

The NCUA Board requested comment on all aspects of the proposed rule and received three comment letters: One from a national trade association, one from a state trade association, and one from a federal credit union (FCU). The two trade associations supported the proposal without qualification. The FCU offered a substantive comment regarding the definition of ''paid-in and unimpaired capital and surplus,'' discussed below. NCUA received no comment on the other provisions in the proposed rule. This preamble does not repeat discussions from the proposal for those provisions and the NCUA Board has adopted them as proposed.

''Paid-in and Unimpaired Capital and Surplus'' and ''Unimpaired Capital and Surplus''

To improve the clarity of NCUA's regulations, the Board proposed to include definitions for ''paid-in and unimpaired capital and surplus'' and ''unimpaired capital and surplus'' in the general definitions part of the regulations. The proposed rule defined ''unimpaired capital and surplus'' as meaning the same as ''paid-in and unimpaired capital and surplus'' and cross-referenced its definition. The proposed definition for ''paid-in and unimpaired capital and surplus'' was a refined statement of the definitions currently in the FCU Bylaws, but did not change the meaning of those definitions or the agency's long-standing interpretation.

The proposed definition for paid-in and unimpaired capital and surplus was shares plus post-closing, undivided earnings. The preamble to the proposed rule stated that the term ''post-closing'' was simpler terminology that a credit union person, an examiner, and an accounting professional would understand to encompass the closing of the books and posting of all relevant and required period losses to undivided earnings. Post-closing undivided earnings incorporates and means the same as the language in the Bylaw provisions that define surplus (''after all losses have been provided for and net earnings or net losses have been added thereto or deducted therefrom'') and define unimpaired capital (''less any losses that may have been incurred for which there is no reserve or which have not been charged against undivided earnings''). The proposed definition further clarified the meaning of paid-in and unimpaired capital and surplus by including the statement that: ''This does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer.''

Amendment to Definition of ''Paid-in and Unimpaired Capital and Surplus'' in the CLF Rule

As stated in the proposed rule, the CLF is a mixed-ownership government corporation created to improve the general financial stability of credit unions by meeting their liquidity needs. 12 CFR 725.1. Both state-chartered and federally-chartered credit unions may become members. 12 CFR 725.3. The Board proposed to revise the current definition in the CLF rule for paid-in and unimpaired capital and surplus. The current CLF rule combines the definition for paid-in and unimpaired capital in the FCU Bylaws with the definition of surplus in the FCU Bylaws and is substantively identical to those provisions. 12 CFR 725.2(o). The current definition includes deposits because some state-chartered credit unions are authorized to accept deposits.

The proposed rule defined paid-in and unimpaired capital and surplus in the CLF rule as shares and deposits plus post-closing, undivided earnings. The proposed definition further stated that the term does not include regular

reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer.

Comments on the Definitions of ''Paid-in and Unimpaired Capital and Surplus''

One commenter expressed the view that the NCUA should simplify the general definition of ''paid-in and unimpaired capital and surplus'' to ''shares and deposits plus unappropriated earnings,'' in order to include the concept of ''unrealized gains or losses on investments'' as part of ''unappropriated earnings.'' The Board disagrees. The Board's view is that ''unappropriated earnings'' are equivalent to ''undivided earnings,'' and neither term includes unrealized gains or losses on investments, since these amounts are not yet earned or realized. Thus, the final rule uses the term ''undivided earnings.''

Regarding the commenter's suggestion that the general definition include deposits, for the reasons stated in the proposed rule, only the CLF definition of ''paid-in and unimpaired capital and surplus'' includes deposits. The general definition does not include them in the final rule.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (primarily those under one million dollars in assets). The final rule will not have a significant economic impact on a substantial number of small credit unions, and therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule would not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget concurred with NCUA's opinion that the final rule does not constitute a major rule, for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. NCUA requested comments on whether its proposed rule was understandable and minimally intrusive, but received no comments in response to this request.

List of Subjects

12 CFR Part 700

Credit unions, Definitions.

12 CFR Part 701

Credit unions.

12 CFR Part 712

Credit unions, Credit union service organizations.

12 CFR Part 715

Audits, Credit unions, Supervisory committees.

12 CFR Part 723

Credit, Credit unions.

12 CFR Part 725

Credit unions, Liquidity.

12 CFR Part 790

Credit unions.

By the National Credit Union Administration Board on December 13, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Interim final rule with request for comments.

SUMMARY: The NCUA Board is amending its chartering and field of membership manual to make two changes to ease regulatory burden on community charters and to update the requirements for a credit union to add an underserved area to its charter. First, an existing community charter need not document in writing how it plans on serving the entire community. Second, the Board is updating the definition of an investment area because of the release of new census data and updated Community Development Financial Institution Fund standards. These amendments will help reduce the costs for community charters and make it easier for credit unions to serve underserved areas.

DATES: *Effective Date:* This rule is effective December 20, 2001. *Comment Date:* Comments must be received on for before February 19, 2002.

ADDRESSES: Comments should be directed to Becky Baker, Secretary of the Board. Mail or hand deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428. Or, you may fax comments to (703) 518–6319, or e-mail comments to *regcomments@ncua.gov. Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: J. Leonard Skiles, Chairman, Field of Membership Task Force, at the above address or telephone: (703) 518–6320 or Michael J. McKenna, Senior Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

NCUA's chartering and field of membership policy is set out in Interpretive Ruling and Policy Statement 99–1, Chartering and Field of Membership Policy (IRPS 99–1), as amended by IRPS 00–01 and IRPS 01–01. The policy is incorporated by reference in NCUA's regulations at 12 CFR 701.1. It is also published as NCUA's Chartering and Field of Membership Manual (Chartering Manual), which is the document most interested parties use and to which references in the following discussion are made.

Community Charters

Last year, the NCUA Board required an existing community charter to address, in either its marketing or business plan or other appropriate separate documentation, how it plans on serving the entire community, including how the credit union will market to the community and what products and services the credit union will offer to assist underserved members in the community. Some in the credit union community refer to this as the community action plan requirement or as CAP, though the final rule does not use that term. The NCUA Board stated in the preamble to the final rule that ''existing credit unions will have until December 31, 2001 to have a plan in place addressing how the credit union will serve the entire community.'' 65 FR 64512, 64518 (October 27, 2000). The Board implemented this rule even while recognizing that there was no tangible evidence that credit unions were not planning on serving their entire community. In fact, the NCUA Board stated that, based ''on the comments of community credit unions and the submissions some of them provided, many community credit unions already have adopted plans and offer products and services designed to serve the entire community.'' 65 FR 64512, 64517 (October 27, 2000).

The NCUA Board notes that, while it certainly has the legal authority to impose this regulatory requirement, it has continued to review the necessity of imposing it on a specific type of federal credit union charter. The NCUA Board, after discussing this issue further with agency staff and the credit union community, has decided to repeal this regulatory requirement. This Board has determined that requiring only certain credit unions to adopt specific written policies addressing service to the entire community, where there is no evidence credit unions are not attempting to serve their entire communities, is not a reasonable regulatory practice, particularly when this regulatory requirement raises little, if any, safety and soundness concerns.

This Board believes that a regulation that does not address a substantiated concern or a potential problem is unnecessary. In this case, absent evidence that community charters are not marketing their services to their entire communities, removing the regulatory requirement is prudent.

Underserved Areas

The addition of underserved areas, as defined in Chapter 3 of the Chartering Manual, to the field of membership of operating credit unions is a continuing priority of the NCUA Board. Three criteria must be met before an underserved area can be added to any federal credit union's field of membership. First, the area must be a local community. Second, the area must also be classified as an investment area as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994, 12 U.S.C. 4703(16). Third, the credit union adding the underserved area must establish and maintain an office or facility in the local community.

Last year, the NCUA Board made it less burdensome for federal credit unions to add underserved areas. 65 FR 64512 (October 27, 2000). The NCUA Board modified its policy by stating that a credit union would not have to demonstrate common interests or interaction for a local community if the underserved area to be served is (1) in a recognized political jurisdiction, i.e., a county or its political equivalent or any contiguous political subdivisions contained therein, and if the population of the requested well-defined area does not exceed 300,000, or (2) in multiple contiguous political jurisdictions, i.e., a county or its political equivalent or any political subdivisions contained therein and if the population of the requested well-defined area does not exceed 200,000. The NCUA Board also stated that it presumed that an underserved area for purposes of the investment area criteria would have significant unmet needs for loans or equity investment if the area met the poverty, median family income, unemployment, distressed housing, or population loss criteria set forth in the Community Development Banking and Financial Institutions Act of 1994. Because of these changes and greater interest by the credit union community, the number of underserved areas added to federal credit union's field of membership increased from 50 in 2000 to 231 as of November 30, 2001.

The NCUA Board is continuing to update this section of the Chartering Manual to encourage further development of credit unions in underserved areas and thereby improve financial services to those most in need. The primary reason for this update is the release of the 2000 census.

The Chartering Manual provides examples of what an investment area is for the purpose of adding an underserved area. The Federal Credit Union Act defines an underserved area

as a local community, neighborhood, or rural district that is an ''investment area'' as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994. The 1994 law permits the Community Development Financial Institutions Fund of the United States Department of the Treasury (CDFI Fund) to further define investment areas. With the release of the 2000 census as well as further expansion of an investment area by CDFI, the Board is updating the definition of an investment area in Chapter 3 of the Chartering Manual. These changes will make the Chartering Manual consistent with the data in the 2000 census as well as the modifications promulgated by the CDFI Fund. These amendments will ultimately make it easier for credit unions to add underserved areas and thus serve more members of modest means.

Interim Final Rule

Since issuance of the community service plan requirement, the credit union community has continued to debate its necessity and benefits. The Board notes that previous comment was overwhelmingly against this type of provision and wishes to consider further comment. The NCUA Board is issuing this amendment to its chartering regulation as an interim final rule because it removes a burdensome regulation and merely updates the agencies definition of an investment area for the purpose of adding underserved areas. The Board believes that both these actions are necessary and in the public interest because of the recent and sudden increase in credit union asset growth and the current uncertainty in the national economy. Furthermore, the Board believes the amendments further the public interest in removing a potentially costly and unnecessary regulatory burden and promotes the efficient use of agency resources and staff. Accordingly, for good cause, the Board finds that, pursuant to 5 U.S.C. 553(b)(3)(B), notice and public procedures are impracticable, unnecessary, and contrary to the public interest; and, pursuant to 5 U.S.C. 553(d)(3), the rule shall be effective immediately and without 30 days advance notice of publication. Although the rule is being issued as an interim final rule and is effective immediately, the NCUA Board encourages interested parties to submit comment on whether the community service plan requirement should be deleted from the Chartering Manual and the definition of investment area for the purpose of adding underserved areas should be finalized in the Chartering Manual.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The NCUA Board has determined that this interim final rule does not increase, and will in fact reduce, paperwork requirements under the Paperwork Reduction Act and regulations of the Office of Management and Budget.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The rule has been submitted to the Office of Management and Budget for its determination of whether this is a major rule.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule only applies to federal credit unions. It will not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose a minimal regulatory burden. We request your comments on whether the proposed amendments are understandable and minimally intrusive if implemented as proposed.

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on December 13, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operation of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board is amending its rule limiting compensation to officials. The amendment changes the definition of the term ''compensation'' to exclude the reimbursement or payment of business-related travel costs for an official to be accompanied by a guest.

EFFECTIVE DATE: This rule is effective January 22, 2002.

FOR FURTHER INFORMATION CONTACT: Dianne M. Salva, Staff Attorney, Division of Operations, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428, or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

NCUA published a proposal to amend its regulation covering travel reimbursements for guests accompanying Federal Credit Union (FCU) officials on business. 66 FR 40641, August 3, 2001. During the sixty-day comment period, NCUA received thirty-seven comment letters. After carefully considering the comments, NCUA is publishing this final rule, which is identical to the proposal.

The Federal Credit Union Act (the FCU Act) and NCUA regulations provide that only one board officer of an FCU may be compensated as such and that no other official may receive compensation for serving as a board or committee member. 12 U.S.C. 1761(c), 1761a; 12 CFR 701.33. NCUA has defined compensation to exclude reasonable and proper expense reimbursement for costs incurred by FCU officials in carrying out the responsibilities of the positions to which they were appointed or elected.

Section 701.33 currently permits reimbursement of a board official and one immediate family member for travel expenses incurred in performing board duties if the payment is necessary and appropriate as determined by the FCU board and is made in accordance with written board policies and procedures. 12 CFR 701.33(b)(2)(i).

To give FCUs additional flexibility regarding the reimbursement of reasonable and proper expenses, NCUA has determined to amend § 701.33(b)(2)(i) to use the term ''guest'' rather than ''immediate family member.'' All other provisions of the regulation remain unchanged. Travel and reimbursement policies must still provide for payment of only those costs that are reasonable in relation to the FCUs resources and financial condition. NCUA cautions FCUs that this proposal has no effect on Internal Revenue Service (IRS) regulations regarding the reporting and taxing of any payments or reimbursements. FCUs should consult their tax advisors or attorneys concerning IRS requirements related to their travel reimbursement policies.

Comments

NCUA received thirty-seven comment letters. Seventeen letters were from natural person credit unions and two were from corporate credit unions. Two were from credit union trade associations. Eight were from state credit union leagues and eight were from credit union officials or other individuals.

Twenty-seven of the commenters strongly support the proposal and applaud the agency efforts to minimize government intrusion and maximize flexibility.

Four commenters opposed it, pointing to possible increases in costs to members and concerns of its effect on family unity. The NCUA Board expects that any increase in costs to members will be minor and will support the business of the credit union. Furthermore, any FCU that adopts a new policy must still limit its travel expenditures to amounts that are reasonable in relation to its resources and financial condition. Of course, the amended rule does not require FCUs to change their current travel expense reimbursement or payment policies. The NCUA Board determined to amend the regulation to allow FCUs greater flexibility to accommodate the needs of officials whose duties include business-related travel. Under the current regulation, FCUs may not pay or reimburse the cost of travel for an official's grandson to accompany her to an FCU-sponsored program, or for an official whose mobility is impaired to be accompanied by an aide, even if the FCU thought it necessary or appropriate. With this amendment, the FCU will have the discretion to adopt policies that provide for the reimbursement or payment of such travel costs. Again, the amendment does not require FCUs to do so.

Five commenters, while generally supportive, suggested that the proposal did not go far enough in expanding credit union authority. These commenters believe that it is unnecessary for NCUA to have a regulation concerning such reimbursements or payments. They suggest that NCUA rescind the regulation so that FCUs can establish reimbursement policies that fit their individual needs. They argue that such policies would be subject to scrutiny in the examination process and would therefore pose no risk to safety and soundness. Two commenters also stated that NCUA should not have a regulation on travel reimbursement, but should rely on the examination process to ensure that FCUs have reasonable and appropriate policies. The NCUA Board believes that it is appropriate for the agency to maintain a regulation in this area. There is a tension between the need of FCUs to attract competent and dedicated officials and the prohibition in the FCU Act against compensating all but one of them. FCUs regularly question NCUA about the permissibility of new types of reimbursements. These new ideas for reimbursements to officials frequently fall beyond the limits of the FCU Act. This regulation provides FCUs with NCUA's interpretation of the FCU Act by clearly stating what types of travel reimbursements NCUA has found to be consistent with the law.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small entities (primarily those under one million dollars in assets). This rule will not have a significant economic impact on a substantial number of small credit unions, and therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that this regulation does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule will

apply only to all federal credit unions. It will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the rule does not constitute a policy that has federalism implications for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget (OMB) has determined that this is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 701

Credit unions, Reporting and recordkeeping requirements, Travel and transportation expenses, Travel restrictions.

By the National Credit Union Administration Board on December 13, 2001.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Loan Interest Rates

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The current 18 percent per year federal credit union loan rate is scheduled to revert to 15 percent on March 8, 2002, unless otherwise provided by the NCUA Board (Board). A 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions. At the same time prevailing market rates and economic conditions do not justify a rate higher than the current 18 percent ceiling. Accordingly, the Board hereby continues an 18 percent federal credit union loan rate ceiling for the period March 8, 2002 through September 8, 2003. Loans and lines of credit balances existing prior to May 18, 1987, may continue to bear their contractual rate of interest, not to exceed 21 percent. The Board is prepared to reconsider the 18 percent ceiling at any time should changes in economic conditions warrant.

DATES: Effective March 8, 2002.

FOR FURTHER INFORMATION CONTACT: Daniel Gordon, Senior Investment Officer, telephone 703–518–6620.

SUPPLEMENTARY INFORMATION:

Background

Public Law 96–221, enacted in 1980, raised the loan interest rate ceiling for federal credit unions from one percent per month (12 percent per year) to 15 percent per year. It also authorized the Board to set a higher limit, after consulting with Congress, the Department of Treasury and other federal financial agencies, for a period not to exceed 18 months, if the Board determined that: (1) Money market interest rates have risen over the preceding six months; and (2) prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

On December 3, 1980, the Board determined that the foregoing conditions had been met. Accordingly, the Board raised the loan ceiling for nine months to 21 percent. In the unstable environment of the first half of the 1980s, the Board lowered the loan rate ceiling from 21 percent to 18 percent, effective May 18, 1987. This action was taken in an environment of falling market interest rates from 1980 to early 1987. The ceiling has remained at 18 percent to the present.

The Board believes that the 18 percent ceiling will permit credit unions to continue to meet their current lending programs and permit flexibility so that credit unions can react to any adverse economic developments.

The Board would prefer not to set loan interest rate ceilings for federal credit unions. Credit unions are cooperatives and balance loan and share rates consistent with the needs of their members and prevailing market interest rates. The Board supports free lending markets and the ability of federal credit union boards of directors to establish loan rates that reflect current market conditions and the interests of their members. Congress has, however, imposed loan rate ceilings since 1934. In 1979, Congress set the ceiling at 15 percent but authorized the Board to set a ceiling in excess of 15 percent, if conditions warrant. The following analysis justifies a ceiling above 15 percent, but at the same time does not support a ceiling above the current 18 percent. The Board is prepared to reconsider this action at any time should changes in economic conditions warrant.

Money Market Interest Rates

Table 1 below shows that interest rates rose between January 11 and February 5 as the nation continues to recover from the combination of the recession and the September 11 terrorist attack.

TABLE 1.—YIELDS ON U.S. GOVERNMENT SECURITIES
[Percent]

Maturity	Jan. 11	Feb. 5	Change
3 month	1.55	1.75	.20
6 month	1.62	1.85	.23
2 year	2.72	2.98	.26
5 year	4.09	4.20	.11
10 year ..	4.86	4.89	.03

Table 2 shows that interest rates on maturities of five years and longer have increased since September 13.

TABLE 2.—YIELDS ON LONGER TERM U.S. GOVERNMENT SECURITIES
[Percent]

Maturity	Sept. 13	Feb. 5	Change
5 year	3.95	4.20	.25
10 year ..	4.62	4.89	.27

There is also evidence in financial markets to suggest that rates are likely to rise in the months ahead. A consensus forecast of economists anticipates higher interest rates this year. In addition, the implied forward curve for U.S. Government securities, a sign of market expectations, indicates that the yields on Treasury securities will be higher in the upcoming year.

There are also indications the economy is improving. For example, Federal Reserve Chairman Greenspan recently said, ''(t)here have been signs recently that some of the forces that have been restraining the economy over the past year are starting to diminish and that activity is beginning to firm.'' The Federal Reserve's Open Market Committee, supporting this view, chose to retain the target fed funds rate rather than lowering it again. Gross Domestic Product showed a 0.2 percent increase in the last quarter of 2001. The Conference Board's index of consumer sentiment increased to 97.3 in January from 94.6 in December. This represents a 5-month high. Rising consumer confidence typically results in more discretionary consumer expenditures.Thus improved consumer confidence is another positive sign for the economy.Typically, as the economy improves interest rates increase. Therefore, there are signs in the economy as a whole, and in the financial markets in particular, to suggest interest rates will be higher in the future.

Financial Implications for Credit Unions

For at least 712 credit unions, representing 11.5 [1] percent of reporting federal credit unions, the most common rate on unsecured loans was above 15 percent. While the bulk of credit union lending is below 15 percent, small credit unions and credit unions that have instituted risk-based lending programs require interest rates above 15 percent to maintain liquidity, capital, earnings, and growth. Loans to members who have not yet established a credit history or have weak credit histories have more credit risk. Credit unions must charge rates to cover the potential of higher than usual losses for such loans. There are undoubtedly more than 712 federal credit unions charging over 15 percent for unsecured loans to such members. Many credit unions have ''Credit Builder'' or ''Credit Rebuilder'' loans, but only report the ''most common rate'' on the Call report for

[1] Of the 6,186 federal credit unions, 3,412 zero balances in the unsecured loan rate categories for the June 2001 reporting period.

unsecured loans. Lowering the interest rate ceiling for federal credit unions would discourage these credit unions from making these loans and many of the affected members would have no alternative but to turn to other lenders who charge much higher rates.

Small credit unions would be particularly affected by lower loan rate ceilings since they tend to have a higher level of unsecured loans, typically with lower loan balances. Table 3 shows the number of credit unions in each asset group where the most common rate is more than 15 percent for unsecured loans.

In addition, credit unions have been actively attempting to increase service to lower-income members and those with marginal credit histories. There has been a significant increase in the number of credit unions engaging in risk-based lending. Imposition of a lower ceiling would substantially constrain these risk-based lending programs.

In addition, should the interest rate charged on loans be subject to a 15 percent ceiling credit unions, where the majority of members are low-income, will incur significant financial strain. Although the percentage of all low-income designated credit unions reporting loan interest rates greater than 15 percent is comparable to the general federal credit union population (13.9 percent versus 11.9 percent), an analysis of low-income credit unions with assets less than $10 million reveal a much more significant impact.

TABLE 3.—ACTIVE FEDERAL CREDIT UNIONS WITH MOST COMMON UNSECURED LOAN RATES GREATER THAN 15 PERCENT

[June 2001]

Peer group by asset size	Total all FCUs	Number of FCUs with greater than 15 percent
$0–2 million	1,496	153
$2–10 million	2,044	269
$10–50 million	1,736	189
$50 million+	910	101
Total	6,186	712

Among the 712 credit unions where the most common rate is more than 15 percent for unsecured loans, 105 have 20 percent or more of their assets (Table 4) in this category. For these credit unions, lowering the rates would threaten their liquidity, capital, earnings, and growth.

TABLE 4.—ACTIVE FEDERAL CREDIT UNIONS WITH MOST COMMON UNSECURED LOAN RATES GREATER THAN 15 PERCENT AND MORE THAN 20 PERCENT OF ASSETS IN UNSECURED LOANS

[June 2001]

Peer group by asset size	Number of FCUs with loan rates greater than 15 percent
$0–2 million	51
$2–10 million	42
$10–50 million	57
$50 million+	32
Total	105

Data from June 2001 reveals that of those credit unions reporting loan interest rates in excess of 15 percent:

- 49 of the 150 federal credit unions (32.7 percent) with less than $2 million in assets are low-income;
- 79 of the 286 federal credit unions (27.6 percent) with less than $5 million in assets are low-income, and
- 97 of the 416 federal credit unions (23.3 percent) with less than $10 million in assets are low-income.

These credit unions offset the cost of generating low-balance loans through the increased interest rates charged. They generally do not have the ability to provide credit card loans and instead grant closed and open-ended loans with the prerequisite underwriting documentation. Further these smaller credit unions generally maintain a higher expense ratio since many are involved with high-transaction accounts that require higher personnel costs and related operational expenses, and do not have economies of scale.

The Board has concluded that conditions exist to retain the federal credit union interest rate ceiling of 18 percent per year for the period March 8, 2002 to September 8, 2003. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear interest at their contractual rate, not to exceed 21 percent. Finally, the Board is prepared to reconsider the 18 percent ceiling at any time during the extension period should changes in economic conditions warrant.

Regulatory Procedures

Administrative Procedure Act

The Board has determined that notification and public comment on this rule are impractical and not in the public interest. 5 U.S.C. 553(b)(3)(B). Due to the need for a planning period prior to the March 8, 2002, expiration date of the current rule, and the threat to the safety and soundness of individual credit unions with insufficient flexibility to determine loan rates, final action on the loan rate ceiling is necessary.

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (those under one million dollars in assets). This final rule provides added flexibility to all federal credit unions regarding the permissible interest rate that may be used in connection with lending. The NCUA Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions.

Paperwork Reduction Act

NCUA has determined that this rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management andBudget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interest. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule applies only to federal credit unions and, thus, will not have substantial direct effects on the states, on the relationship between the national government and the states, nor materially affect state interests. The NCUA has determined that the rule does not constitute a policy that has any federalism implication for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Loan interest rates.

By the National Credit Union Administration Board on February 7, 2002.

Becky Baker,

Secretary to the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702 and 741

Prompt Corrective Action; Requirements For Insurance

AGENCY: National Credit Union Administration (NCUA)

ACTION: Final rule.

SUMMARY: NCUA is revising its rule concerning financial and statistical reports to require all federally-insured credit unions to file quarterly Financial and Statistical Reports with NCUA. Currently, only federally-insured credit unions with assets over $50 million must file these reports quarterly. All other federally-insured credit unions are required to file these reports semi-annually. The final amendment is a necessary component of NCUA's examination program that will use a risk-focused approach to examinations and extend the examination cycle for credit unions that meet certain criteria. In conjunction with this change, we are making two conforming changes to NCUA's prompt corrective action rule.

DATES: This rule is effective July 1, 2002.

FOR FURTHER INFORMATION CONTACT: Peter Majka, Data Analysis Officer, Office of Examination and Insurance, 1775 Duke Street, Alexandria, VA 22314, or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

On July 26, 2001, the NCUA Board requested comment on a proposed change to § 741.6(a), the provision governing the filing of quarterly Financial and Statistical Reports, also known as call reports or 5300 Reports. 66 FR 40642 (August 3, 2001). In conjunction with this change, the NCUA Board proposed revising its prompt corrective action rule to eliminate the requirement of written notice to NCUA of net worth changes and the option of filing a call report for the first and third quarter for credit unions that file call reports semi-annually. 12 CFR part 702.

NCUA received 65 comments regarding the proposed changes from 34 federal credit unions, 14 federally-insured state chartered credit unions, one non-federally-insured state chartered credit union, one unidentified credit union, one individual, nine credit union leagues, three credit union trade associations, one bank trade association, and one state supervisory authority (SSA).

Summary of Comments

Quarterly Call Reports

Forty-four of the commenters generally supported the revision to § 741.6(a), of which 11 agreed with one or more conditions stipulated. Twenty-one commenters objected to the proposed change. Overall, many of the commenters expressed concern regarding the additional burden quarterly reporting would place on credit unions, especially smaller credit unions. Several commenters provided suggestions for reducing the additional burden.

The 33 commenters that supported the changes without qualification believed the proposal would: (1) Result in an offsetting time savings for credit unions through the Risk Based Examination Scheduling Program; (2) help NCUA and the SSAs to identify emerging problems in a timely manner; and, (3) permit NCUA and the SSAs to concentrate their supervisory resources on those credit unions that represent a risk.

Negative and qualified commenters expressed concern with the additional time and resource burden on credit unions. Thirty of the commenters are particularly concerned with the effect on small credit unions. Seven commenters noted that smaller credit unions have to work harder to compete. They noted that smaller credit unions usually have a limited number of staff members and believe the limited resources of smaller credit unions could be better used to increase assets and services.

Ten commenters generally did not believe it was necessary for credit unions rated a CAMEL Code 1 and 2 to file quarterly call reports. Several of the commenters did not believe a credit union's financial condition would deteriorate in a 3 to 6 months time frame. Two commenters noted that the burden of completing two more call reports was more detrimental than having a yearly examination; one of which believed examiners and auditors were effective in correcting problems and providing guidance. Four of the commenters suggested that CAMEL Code 1 and 2 credit unions and those credit unions with a long-term trend of stability that have been in existence for more than a few years should be required to file call reports on a semi-annual basis. Three commenters who opposed the proposal noted that the proposed rule will result in the additional collection of information for a small percentage of the industry's credit union assets and therefore is not necessary.

The NCUA Board believes the requirement for filing quarterly call reports is a key element in implementing the Risk Based Examination Scheduling and Risk Focused Examination programs. CAMEL Code 1 and 2 credit unions, no matter the asset size, could be eligible for deferral under the Risk Based Examination Program for one examination cycle. Quarterly filing enhances NCUA's ability to allocate its resources effectively and focus its supervisory efforts on risk regardless of a credit union's asset size. NCUA's 2002 operating budget included a reduction of approximately 33 full-time equivalent staff positions. The deferral of examinations for approximately 1,500 federal credit union with assets under $50 million and the implementation of the Risk Based Examination Scheduling Program were contributing factors to the budgeted staff reductions. In addition, quarterly call reports also provide credit unions, the SSAs, and NCUA with the ability to monitor trends and expeditiously address emerging concerns in an ever-changing economic environment. Overall, the NCUA Board believes the benefits and efficiencies derived from the Risk Based Examination Scheduling and Risk Focused Examination programs outweigh the burden of two additional call reports.

Several commenters believe the proposal places a burden on state-chartered credit unions without providing a corresponding benefit. They noted that the state regulator sets their exam cycle and that this rule may have no effect on their examination cycle or their supervisory fees. Two additional commenters stated that the additional call reports would put a strain on the SSAs' supervisory resources. They urge NCUA to be sensitive to the SSAs' budgetary restraints and work with the SSAs to implement quarterly reporting in a manner compatible with their budgetary processes.

Many SSAs are reviewing the possibility of including NCUA's Risk Based Examination Scheduling and Risk Focused Examination programs in their supervisory programs. The NCUA Board believes a key benefit of the Risk Based Examination Scheduling Program is the ability to delay examinations for one examination cycle for the well-run, financially strong credit unions. The program, if adopted by the SSAs, should assist the SSAs in focusing their supervisory resources on areas of risk regardless of the credit unions' asset size.

In addition, as manager of the NCUSIF, NCUA needs quarterly

financial information from all federally-insured credit unions in order to assess risk to the NCUSIF on a timely and ongoing basis.

Currently, seven state regulators require quarterly call reports and some state regulators have NCUA process their credit unions' call reports. Each SSA could contact their respective Regional Director for assistance, if needed, in gathering and uploading the call reports. NCUA will continue to remain sensitive to the SSA's budgetary restraints. As noted previously, the NCUA Board, primarily through its adoption of the Risk Based Examination Scheduling Program, has been able to reduce its staffing needs by approximately 33 full-time equivalent positions.

One commenter did not believe that the benefit the Central Liquidity Facility (CLF) would receive from more frequent reporting justifies the implementation of quarterly call reports due to the CLF's loan volume. The NCUA Board noted in the proposal that the CLF would have the most recent financial information to help evaluate a credit union's CLF loan request. The NCUA Board did not consider this a primary reason for proposing quarterly call reports. The Board recognizes that the CLF's loan volume is low. However, the CLF's main purpose is to provide emergency liquidity to the credit union system as quickly as possible when other traditional liquidity sources are unavailable. The Board believes quarterly call reports will expedite the loan evaluation process. The ability to quickly provide liquidity under emergency circumstances benefits all credit unions.

Twenty-five commenters suggested NCUA develop a shorter version of the call report for credit unions. Most of the commenters recommended that credit unions with various asset thresholds ranging from under $500,000 to $50 million be permitted to file a short version of the call report. Two commenters in support of an abbreviated form for smaller credit unions suggested that, if a more complex version is needed during the 5300 process, NCUA could e-mail or FAX a copy to the credit unions. Seven commenters suggested requiring an abbreviated version of the 5300 for the first and third quarters.

Four commenters opposed the development of a short version of the call report. One or more of these commenters stated: (1) A short version would not provide timely and complete information for identifying emerging trends; (2) a short version is unnecessary; and (3) only one format should exist in order to avoid confusion and the need for NCUA to provide follow-up for additional information.

Several years ago, NCUA redesigned the call report with small credit unions in mind. NCUA developed a core call report, with supporting schedules that provided more detail if required. The NCUA Board remains sensitive to this issue. Upon further review and the comments received, the NCUA Board has decided to develop a short form 5300 that does not compromise NCUA's and the SSAs' ability to provide adequate supervision. Credit unions with assets of less than $10 million will be required to file the complete version of the Form 5300 for the second and the fourth quarters of the year and may file either the short version or the long version of the 5300 for the first and third quarters of the year.

Five commenters emphasized the need to minimize the frequency of changes to the call report format. One commenter suggested that the call report be color coded to provide guidance to credit unions in preparing those sections of the call report that apply to their operations.

The NCUA Board remains committed to requiring the minimum information needed to provide adequate supervision. The Board believes NCUA has a process that works to assure unnecessary information is not requested on the call report. NCUA's 5300 Working Group, which includes an SSA representative, generally reviews changes to the call report once a year. However, changes may need to be made more frequently due to regulatory changes. Before implementation, any recommended changes go through a review process that considers the burden a change would place on credit unions versus the benefit to be gained.

Several commenters made suggestions regarding the use of technology. One commenter stated that quarterly call reporting would not be a burden to credit unions if their data systems were automated and suggested that NCUA and the credit union industry provide support to unautomated filers such as discounts to purchase personal computers. With this support, NCUA should establish a timetable to discontinue manual remittance of the call report. The NCUA Board does not believe it is necessary to impose upon credit unions a requirement to file electronic versions of the call report. During the June 30, 2001, call report cycle, 9,686 federally-insured credit unions, out of 10,415, filed their call reports using the PC 5300 automated system. Credit unions need to evolve towards understanding the benefits and responsibilities associated with using automated data systems within the scope of their operations. Furthermore, the Board believes it would be more appropriate for another party, such as a credit union trade association, to seek discounts on the purchase of computers for credit unions.

Two commenters suggested that NCUA alleviate the burden of submitting call reports by initiating uploads of call reports to its database. Currently, NCUA offers credit unions the ability to e-mail an electronic version of their completed call report to their examiner or SSA for uploading. NCUA staff plans to develop improved methods for filing call reports as NCUA's technological capabilities improve.

One state-chartered credit union commenter suggested the burden for credit unions could be reduced by automating the Reserve Sheet into a schedule versus a separate remittance sheet. The Reserve Sheet is a supplemental schedule required by the credit union's SSA. This suggestion should be provided to the credit union's state examiner for consideration.

One commenter questioned to what extent NCUA's AIRES (Automated Integrated Regulatory Examination System) Program duplicates the call report program. The commenter suggested that an AIRES download be created each quarter and the call report be used simply to fill in information not available through AIRES. The NCUA Board does not believe this is a viable alternative. AIRES only has the capacity to download certain financial information from a credit union's data system. Any download performed would require an examiner to go on-site or receive a diskette that requires an additional download into the call report system. Effective September 1, 2002, an examiner will be able to download the most recent call report information into AIRES for an examination. This will help reduce the amount of time needed for an examiner to be on-site.

One commenter made two suggestions to mitigate the potential financial impact on small credit unions. The first recommendation is that NCUA should work with data processors to develop a standard report format consistent with available software. The NCUA Board believes the credit union industry needs to address this matter with its vendors. NCUA can provide the specifications to the vendors upon their request and has done so in the past.

The second recommendation is that NCUA delay the March 2002 quarterly reporting implementation date until the data processing standard report format

previously discussed is complete. NCUA is in the process of developing a shortened version of the 5300 for use during the first and third quarters of the year for credit unions with assets of less than $10 million. This short form will not be available until the September 2002 reporting cycle, so the NCUA Board is delaying the effective date of the final rule to July 1, 2002.

One commenter suggested that NCUA develop an electronic worksheet to reduce the preparation time. The Board does not believe a worksheet would assist credit unions in preparing the call report. The call report is in an electronic format. The current call report format includes detailed summary schedules regarding various general operational matters for all credit unions. The Board believes credit unions would be best served by requesting their data processing vendors to develop any detailed summary reports of the information they need to complete the call report.

Five commenters made suggestions regarding a phase-in process for NCUA's implementation of the proposal to help alleviate the burden on credit unions not currently required to file quarterly call reports. Two suggested that quarterly reporting should be phased in over two or three years; one of which suggested that NCUA initially consider only those credit unions for the Risk Based Examination Scheduling Program that are currently required to file quarterly call reports. One suggested that credit unions under $50 million in assets have the option of filing on a quarterly basis. In both cases, those credit unions filing on a quarterly basis would be considered for an extended examination cycle. One commenter suggested that the implementation of quarterly reporting should be delayed to allow sufficient time to adjust staff and operations.

Although the Board is delaying effective date of the regulation, the Board does not believe the extensive delays suggested by the commenters are viable options. The suggestions would delay a smooth transition towards the risk-focused approach to supervising credit unions. In addition, the savings currently reflected in NCUA's 2002 operating budget may not be fully realized if the suggestions were adopted.

Three commenters suggested excluding credit unions with assets of $10 million or less from quarterly reporting for five years. After five years, smaller credit unions should have access to electronic record keeping and should be better able to handle the additional record keeping requirements.

The NCUA Board does not agree with these suggestions. The Board notes that a credit union must file a quarterly call report to qualify for a deferred examination under the Risk Based Examination Scheduling Program. Any qualifying credit union would be excluded from receiving the benefit of a delayed examination. Reducing the number of credit unions qualifying for the program would impact the staff reductions projected in NCUA's approved 2002 budget. In addition, quarterly call reports are intended to reveal emerging problems through quarterly trend analysis so any noted concerns can be addressed in an expeditious manner. This applies to all credit unions no matter what their asset size, capital position, or CAMEL Code. As previously explained, in an effort to ease the burden, the NCUA Board will have staff develop a short form 5300 for credit unions with assets of less than $10 million that does not compromise NCUA's and the SSAs ability to provide adequate supervision for use during the first and third quarters of the year.

Two commenters believed that, instead of quarterly reporting, the burden of collecting any needed additional information should be shifted to the regulator. One suggested that more on-site contacts be scheduled; the other suggested that the regulators receive monthly financial statements.

The NCUA Board does not believe these are viable alternatives. These suggestions diminish the economies that will result from implementing the Risk Based Examination Scheduling Program. In all likelihood, NCUA's current projected reduction in staffing levels may not be fully realized if these suggestions were adopted.

Four commenters conditioned their support of the proposal on the implementation of the Risk Based Examination Scheduling Program. Another commenter, who agreed with the proposal, voiced the concern that, once quarterly call reporting was implemented, the Risk Based Examination Scheduling Program may stop and the credit unions would still have to file quarterly call reports. The NCUA Board has adopted the program through the approval of the 2002 NCUA budget. However, quarterly call reporting has benefits other than the potential deferral of examinations over one examination cycle. Quarterly reporting provides both the credit unions and the regulators the ability to timely detect emerging concerns in an ever-changing economic environment. NCUA, in cooperation with the SSAs, reviews call report requirements at least annually and makes adjustments to the reporting requirements after weighing the benefit gained versus the burden that additional reporting places on the credit unions.

Notice of Requirement To Report Under Prompt Corrective Action

Six commenters provided comments regarding the proposed change eliminating the requirement of § 702.101(c) for written notice from a credit union when its net worth decreases. Four of the commenters agreed with the change; two did not agree. The two objecting commenters did so because they objected to the proposed rule as a whole.

The NCUA Board recognizes that the filing of quarterly call reports obviates the need for written notice and it is deleting this requirement from the rule.

Final Change

Based on the comments received, the NCUA Board is modifying the proposed changes to § 741.6(a). The NCUA Board will have staff develop a short form 5300 that may be used by credit unions with assets under $10 million for the first and third quarters of each year. In addition, the NCUA Board will make the final rule's effective date July 1, 2002. This effective date will provide NCUA staff with sufficient time to develop the short version of the 5300 for use during the year 2002's third quarter call report cycle and the first and third quarters' reporting cycles for each year thereafter.

Currently, this section requires all federally-insured credit unions with assets in excess of $50 million to file a quarterly call report with NCUA. All other federally-insured credit unions file semiannually. The final amendment will require all federally-insured credit unions to file quarterly call reports. Credit unions with assets of less than $10 million will be required to file the complete version of the Form 5300 for the second and the fourth quarters of the year and may file either the short or the complete version of the 5300 for the first and third quarters of the year.

This amendment is a necessary component of NCUA's revised examination program. The revised examination program has two new features. The first is risk-based examination scheduling that will result in an extended examination cycle program for credit unions meeting certain risk criteria. Approximately 1,500 federal credit unions under $50 million will participate in the extended examination cycle program during the 2002 NCUA budget year. Requiring those credit unions to file quarterly call reports is an essential part of their

participation. The credit unions' financial condition must be monitored over the examination cycle to identify emerging trends that may impact the safety and soundness of the credit unions' operations.

The second is a risk-focused approach for all examinations. The risk-focused approach will focus the examination process on those operational areas that represent the greatest risk to the credit union. The process includes evaluating the credit union's financial trend information and management's ability to identify and adapt to changing economic, competitive, technological, and other factors.

These two features will permit NCUA to adjust the examination process for a select number of credit unions based on workload demands in relation to available resources and the risk the credit unions represent to the National Credit Union Share Insurance Fund. Both features will result in better use of available resources and reduce the amount of NCUA on-site contact time needed to assess the overall financial health of federally-insured credit unions. Quarterly financial information will provide NCUA the ability to administer these approaches successfully through off-site review of a credit union's financial trends to detect emerging problems.

In conjunction with the change to § 741.6(a), the Board is making a technical correction to § 741.6(b) by deleting the reference to semi-annual reporting and revising the prompt corrective action rule to eliminate the requirement of written notice to NCUA and the option of filing a call report for the first and third quarter for credit unions that file call reports semi-annually. 12 CFR 702.101(c), 702.103(b).

Regulatory Procedures

Paperwork Reduction Act

The NCUA Board has determined that the final rule to require all federally-insured credit unions to file call reports on a quarterly basis is covered under the Paperwork Reduction Act. NCUA submitted a copy of the proposed rule to the Office of Management and Budget (OMB) for its review. The OMB Control Number for the call report is 3133–0004.

The Paperwork Reduction Act of 1995 and OMB regulations require that the public be provided an opportunity to comment on the paperwork requirements, including an agency's estimate of the burden of the paperwork requirements. Although no commenters specifically commented on the paperwork requirements, their comments on the proposed rule indirectly addressed some of the issues.

The NCUA Board estimated in the proposal that it takes a federally-insured credit union six hours on average to complete a call report. The proposal, using the six-hour call report average, estimated the rule would result in an additional 100,272 hours of call report preparation. Sixteen commenters' reported an average of 10 hours to complete a call report. Three of the commenters were credit union trade associations that surveyed their membership. NCUA has determined, based on the comments and its own research that a more accurate average for call report preparation is eight hours. This eight hour average does not take into account the fact that the proposed amendments only apply to credit unions under $50 million. NCUA's research and the comments indicate that the time to prepare a call report decreases with the size of the credit union. In addition, the proposal did not include a short form option for credit unions under $10 million. This will affect 5,864 federally-insured credit unions. Since the final amendments only apply to credit unions under $50 million and a short form is being created for credit unions under $10 million, NCUA concludes that its original net burden estimate may have overestimated the additional hours resulting from the rule change.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601–612)(RFA) requires, subject to certain exceptions, that NCUA publish an initial regulatory flexibility analysis (IRFA) with a proposed rule and a final regulatory flexibility analysis (FRFA) with a final rule, unless NCUA certifies that the rule will not have a significant economic impact on a substantial number of small credit unions. For purposes of the Regulatory Flexibility Act, and in accordance with NCUA's authority under 5 U.S.C. 601(4), NCUA has determined that small credit unions are those with less than one million dollars in assets. See 12 CFR § 791.8(a) and NCUA's Interpretive Ruling and Policy Statement, No. 87–2. NCUA's final rule will apply to approximately 1,489 small credit unions, out of 10,316 federally-insured credit unions. Of these 1,489 small credit unions, approximately 55 of the federally-insured state chartered credit unions are already required to file quarterly call reports by their respective SSAs.

At the time of issuance of the proposed rule, NCUA could not make such a determination for certification. Therefore, NCUA issued an IRFA pursuant to section 603 of the Regulatory Flexibility Act. After reviewing the comments submitted in response to the proposed rule, NCUA believes it does not have sufficient information to determine whether the final rule would have a significant economic impact on a substantial number of small credit unions. Therefore, pursuant to section 604 of the Regulatory Flexibility Act, NCUA provides the following FRFA.

The FRFA incorporates NCUA's initial findings, as set forth in its IRFA, addresses the comments submitted in response to the IRFA, and describes the steps NCUA plans to take to minimize the impact on small entities. Currently, all federally-insured credit unions, no matter their asset size, are required to file call reports semi-annually. The current call report contains explicit instructions for completing the report. NCUA will continue this practice for the two additional call reports required from credit unions with assets under $50 million. We believe the instructions meet the requirement to provide guidance to small credit unions in complying with this rule, under Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996 (P.L. 104–121).

1. Statement of Need

The final amendment will provide NCUA and the SSAs with timely and complete financial data to be used in supervising their credit unions as discussed in the Final Change section above. The adoption of the final amendment to § 741.6(a) of the NCUA's regulations will account for all of the economic impact on small credit unions.

2. Statement of Objectives and Legal Basis

The Final Change section above contains this information. The legal basis for the final rule is in the Federal Credit Union Act. 12 U.S.C. 1756 and 1782.

3. Burdens and Cost Upon Small Credit Unions with the Adoption of this Rule

In general, the commenters were concerned with the additional time and resource burden that would be placed on credit unions if the amendment to the rule were adopted. Thirty of the commenters were specifically concerned with the burden that would be placed on small credit unions. Seven of the commenters noted that smaller credit unions have a limited number of staff members. Several commenters provided various opinions as to what credit union asset size they considered

as ''small''. The asset sizes noted varied within the range of less than $500,000 to less than $50 million in assets.

As noted previously, the combined credit union surveys calculated eight hours as the average for all credit unions to complete a call report. For credit unions with assets of $10 million or less, the average time was five hours. One credit union league commenter surveyed mostly small credit unions. The league reported six hours as the average time to complete a call report. We could not determine from the comments provided the average hours calculation for credit unions with assets less than one million dollars. However, NCUA calculated three hours as the average for credit unions with assets less than two million dollars based on its own research. The commenters did not provide any specific dollar cost estimates associated with quarterly call reporting.

4. Discussion of Significant Alternatives To Alleviate Burden

In the proposal, NCUA considered the following alternative approaches in reducing the burden on smaller credit unions:

a. Federally-Insured Credit Unions With Assets Less Than $10 Million

NCUA considered revising the regulation to require only federally-insured credit unions with assets greater than $10 million to file quarterly call reports. This alternative was not pursued due to the changes in NCUA's examination program. Although the NCUA Board has not been persuaded to change its original determination, as discussed below, the Board has made some adjustments to the requirements to reduce the burden on these credit unions. The NCUA Board has adopted the new examination program through its approval of NCUA's 2002 Budget. Approximately 950 federal credit unions with assets less than $10 million have been considered in NCUA's 2002 Budget for examination deferral under the Risk Based Examination Scheduling Program. Of these 950 federal credit unions, approximately 120 have assets less than one million dollars. The program permits deferral of an examination for every other examination cycle. The NCUA Board believes quarterly reporting is necessary to monitor the credit union's financial trends during the deferral period. The NCUA Board believes the burden of the additional hours it takes a credit union to prepare two additional call reports is outweighed by the advantages outlined in the Final Change section.

b. 5300 Short Form

NCUA originally considered the alternative of requiring a credit union with assets of less than $10 million to file a short version of the call report during the March and September cycles. The short form would reduce the burden for those credit unions. The NCUA Board was initially concerned that this alternative may result in insufficient trend information when compared to the full semi-annual call report. However, upon further review and the comments received, the NCUA Board will have staff develop a short form 5300 that does not compromise NCUA's and the SSAs' ability to provide adequate supervision for use during the first and third quarters of the year.

5. Proposed Reporting, Record Keeping, and Other Compliance Requirements

The information collection requirements imposed by the final rule are discussed above in the section on the Paperwork Reduction Act.

6. General Requirements

The proposed rule will require all federally-insured credit unions to file quarterly call reports. The call reports are based on financial and other information relevant to a federally-insured credit union's operations. Federally-insured credit unions with assets of $50 million or more are already required to file quarterly reports. A final short version of the call report will be developed for credit unions with assets of $10 million or less. Staff anticipates the short form will be available for September 2002 call report cycle. Credit unions meeting the asset size requirements will be permitted to use the short form during the first and third quarters of each year.

Requiring quarterly call reports is a sound business practice that would provide: (1) A more cost effective supervisory effort when coupled with NCUA's proposed examination approaches; and (2) a quarterly operational monitoring tool for the credit unions.

7. Identification of Duplicative, Overlapping, or Conflicting Federal Rules.

NCUA is unable to identify any federal statutes or rules that duplicate, overlap or conflict with the proposed rule; however, NCUA has identified seven states that already require their state-chartered federally-insured credit unions to file quarterly call reports. Although the final rule duplicates those state's requirements, it does not impose any significant, additional burden on those federally-insured credit unions.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntary complies with the executive order. The final rule will not have substantial direct effect on the states, on the relationship between the national government and states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined the proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has determined that, for purposes of SBREFA, this is not a major rule.

Treasury and General Government Appropriations Act, 1999

NCUA has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose minimal regulatory burdens. The regulatory change is understandable and imposes minimal regulatory burden. NCUA requested comments on whether the proposed rule change was understandable and minimally intrusive if implemented as proposed. No comments were received.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and record keeping requirements.

12 CFR Part 741

Bank deposit insurance, Credit unions.

By the National Credit Union Administration Board on March 13, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board is amending its chartering and field of membership manual to make four changes to ease regulatory burden. First, applicants need not submit documentation to establish a community area that is the same as one the NCUA has previously determined to be a well-defined local community, neighborhood or rural district. Second, the Board is deleting the category of common characteristics and background of residents from the examples of acceptable documentation because this category has proven to generate documentation of limited relevance. Third, an existing community charter need not document in writing how it plans on serving the entire community. Fourth, the Board is updating the definition of an investment area because of the release of new census data and updated Community Development Financial Institution Fund standards.

EFFECTIVE DATE: May 24, 2002.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Chairman, Field of Membership Task Force, 1775 Duke Street, Alexandria, Virginia 22314 or telephone (703) 518–6540 or Regina Metz, Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314 or telephone (703) 518–6540 or Lynn Markgraf, Program Officer, Office of Examination and Insurance, 1775 Duke Street, Alexandria, Virginia 22314 or telephone (703) 518–6396.

SUPPLEMENTARY INFORMATION:

Background

NCUA's chartering and field of membership policy is set out in Interpretive Ruling and Policy Statement 99–1, Chartering and Field of Membership Policy (IRPS 99–1), as amended by IRPS 00–01. The policy is incorporated by reference in NCUA's regulations at 12 CFR 701.1. It is also published as NCUA's Chartering and Field of Membership Manual (Chartering Manual), which is the document most interested parties use and to which references in the following discussion are made.

In 2001, the NCUA Board issued two interim final rules on chartering and field of membership. In this document the Board is finalizing both rules as IRPS 02–2. Each rule and each amendment is discussed separately below.

March Interim Final Rule

On March 8, 2001, the NCUA Board issued IRPS 01–1, an interim final rule with a sixty-day comment period, amending the Chartering Manual. 66 FR 15619 (March 20, 2001). The comment period ended on May 21, 2001. Nine comments were received. Comments were received from two Federal credit unions, four state credit union leagues, one national credit union trade association and two bank trade associations. Almost all of the commenters supported both of the interim final rule's field of membership changes. Most of these commenters believe these amendments will reduce documentation requirements and save Federal credit unions time and funds in converting to a community charter.

1. Previously Established Communities

The Chartering Manual requires community charter applicants to establish that an area is a ''well-defined local community, neighborhood, or rural district.'' Chartering Manual, Chapter 2, V.A.1. It provides that an applicant may submit a letter describing how the area meets the standards for interaction or common interest for certain geographic and population sizes, namely, a single political jurisdiction such as a county with 300,000 or fewer people, or multiple, contiguous political jurisdictions with 200,000 or fewer people. Applicants must submit maps and information about the area's population and political jurisdiction.

For larger areas in terms of population and geographic size, the Chartering Manual provides for applicants to submit a narrative summary and documentation supporting the finding of interaction and common interests in the proposed community. The Chartering Manual provides examples of the type of documentation that an applicant may submit but does not require or specify particular documentation.

In the interim final rule, the NCUA Board stated that applicants need not submit documentation to establish a community area that is the same as one the NCUA has previously determined to be a well-defined local community, neighborhood or rural district. Eight commenters fully supported this amendment. One commenter did not understand the amendment. The Board believes this amendment provides a common sense approach for documentation requirements by eliminating redundant proof by subsequent applicants for the same geographic area that either it or a regional director has already addressed. Therefore, the NCUA Board is adopting this interim final amendment without change.

Applicants need only identify in their applications the fact of the prior approval and their reliance on the summary and documentation already part of the agency's records. The community area must be identical to a previously approved application. No variance is allowed. Nevertheless, applicants may be required to submit their own summary and documents if the agency has reason to believe that the documents on file from previous applications are no longer accurate or are insufficient.

Two commenters stated that this policy should be revisited periodically since the community aspect of a geographic area may change over time. One commenter suggested five years and another suggested ten years. Another commenter asked that the agency provide further guidance on when the agency might require applicants to submit their own summary and other documents if the agency has reason to believe the documents on file from previous applicants are no longer accurate or are insufficient. Basically, the agency will require more information if there has been a significant and quantifiable change in a community's characteristics. The NCUA Board believes that communities may change over time and will revisit the time frame for action when necessary.

One commenter requested that NCUA consider permitting a credit union converting to a community charter to add new members from their groups that are located outside the community boundaries. This comment is unrelated to the interim final rule but the NCUA Board has decided to continue its current policy on groups outside the community.

2. Documentation Requirements

The Chartering Manual provides examples of documentation that applicants may consider using to support the area as a community, neighborhood, or rural district. One of these examples was: ''common characteristics and background of residents (for example, income, religious beliefs, primary ethnic groups, similarity of occupations, household types, primary age, group, etc.).'' *Id.* at 2–46. This documentation has proven to

be of limited relevance in determining whether the area meets the community requirements. Therefore, in the interim final rule the Board deleted the category of common characteristics and background of residents from the examples of acceptable documentation because it has proven to generate documentation of limited relevance. Eight commenters approved of this amendment, although one commenter believes this type of information can be useful in showing interaction or common interests. For the reasons stated above, the Board is adopting this amendment in final.

These two final amendments will help reduce the time involved in the community application process, reduce costs for credit unions seeking to serve a previously approved community, and reduce regional and Board staff time and preparation.

The Board wants to note that these amendments only apply to required documentation to support the proposed area as a community. They do not eliminate any of the remaining requirements necessary to process a community application, such as addressing safety and soundness concerns and the requirement for business and marketing plans.

December Interim Final Rule

On December 13, 2001, the NCUA Board issued an interim final rule with a sixty-day comment period amending the Chartering Manual. 66 FR 65625 (December 20, 2001). The comment period ended on February 19, 2002.

Although the Board actually received 494 comment letters or e-mail messages, NCUA staff has credited multiple comment letters from the same credit union or the same source as one comment, for a total of 428 comments. Comments were received from 260 Federal credit unions, 120 state chartered credit unions, 4 national credit union trade associations, 23 state credit union leagues, 2 bank trade associations, 2 community groups, 1 financial group and 16 members or otherwise unidentified persons.

1. The Provision Commonly Referred to as the Community Action Plan (CAP)

In October 2000, the NCUA Board required an existing community charter to address, in either its marketing or business plan or other appropriate separate documentation, how it plans on serving the entire community, including how the credit union will market to the community and what products and services the credit union will offer to assist underserved members in the communities. Some in the credit union community refer to this as the ''community action plan'' requirement or as ''CAP'', though the final rule did not use that term. The NCUA Board stated in the preamble to the final rule that ''existing credit unions will have until December 31, 2001, to have a plan in place addressing how the credit union will serve the entire community.'' 65 FR 64512, 64518 (October 27, 2000). The Board implemented this rule even while recognizing that there was no tangible evidence that credit unions were not planning on serving their entire community. In fact, the NCUA Board stated that, based ''on the comments of community credit unions and the submissions some of them provided, many community credit unions already have adopted plans and offer products and services designed to serve the entire community.'' 65 FR 64512, 64517 (October 27, 2000).

The NCUA Board issued an interim final rule on December 13, 2001, eliminating this regulatory requirement, known as CAP. Four hundred and fifteen commenters supported the elimination of the regulatory requirement. Most of the commenters applauded the Board's decision to repeal this unnecessary regulatory burden because they believe it is something credit unions are already doing. The commenters who supported the Board's action primarily made the following points: (1) Credit unions do not need a regulation requiring them to serve their members; (2) credit unions are serving low-income people by adding underserved areas to their fields of membership; (3) community charters naturally serve their entire communities; (4) Congress specifically rejected similar requirements in the Credit Union Membership Access Act; (5) there is no evidence that community credit unions are not serving their entire fields of membership adequately; (6) the rule is not directly related to safety and soundness; (7) the rule was costly and burdensome to implement; (8) the rule was similar to Community Reinvestment Act requirements.

Many commenters discussed how credit unions reach out and serve low-income members. Many commenters stated that ''continued improvements in NCUA's membership application process are more appropriate than a CAP rule and will do more to ensure all individuals, including disadvantaged groups, are eligible for credit union service.'' The Board believes this comment addresses the fact that the agency has streamlined its SEG approval process and underserved area approval process. The Board will continue to study methods to streamline the field of membership process.

Twelve commenters opposed the repeal of CAP and requested that it be reinstated. One additional commenter, a credit union, was not sure of its position on this issue. The primary contentions of commenters opposing the repeal of CAP were that CAP is good for credit unions and its burden is minimal. They believe CAP is a simple requirement to help ensure that credit unions serve their entire communities. A few commenters objected to the process of using an interim final rule to repeal CAP. A few commenters did not understand the rule and believe that, under CAP, a credit union would make its written plan available to the public.

In general, the Board agrees with the commenters who supported the repeal of CAP. Therefore, the Board is adopting this amendment as a final rule because the Board continues to believe that it is an unreasonable practice to require only certain credit unions to adopt specific written policies addressing service to the entire community, without any evidence these credit unions are failing to serve their entire communities. In addition, this regulatory requirement addresses few, if any, safety and soundness concerns.

This Board believes that a regulation that does not address a substantiated safety and soundness concern or a potential problem is unnecessary. In this case, the Board believes it is prudent to eliminate this regulatory requirement because there is no evidence that community charters are not marketing their services to their entire communities.

2. Underserved Areas

The addition of underserved areas, as defined in Chapter 3 of the Chartering Manual, to the field of membership of operating credit unions is a continuing priority of the NCUA Board. A Federal credit union seeking to add to its field of membership an underserved area first must meet a three-prong test. First, the area must be a local community. Second, the area must also be classified as an investment area as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994, 12 U.S.C. 4703(16). Third, the credit union adding the underserved area must establish and maintain an office or facility in the area, or have a preexisting office within close proximity.

In October 2000, the NCUA Board made it less burdensome for federal credit unions to add underserved areas. 65 FR 64512 (October 27, 2000). Because of these changes and the credit

union community's greater interest, the number of underserved areas added to Federal credit union's field of membership increased from 50 in the year 2000 to 281 in 2001.

The Chartering Manual provides examples of an ''investment area'' for the purpose of adding an underserved area. The Federal Credit Union Act defines an ''underserved area'' as a ''local community, neighborhood, or rural district'' that is an ''investment area'' as defined in Section 103(16) of the Community Development Banking and Financial Institutions Act of 1994. The 1994 law permits the Community Development Financial Institutions Fund of the United States Department of the Treasury (CDFI Fund) to further define investment areas. In the interim final rule, the Board updated the definition of an investment area in chapter three of the Chartering Manual by incorporating 2000 census data and the CDFI Fund's updated definition of an investment area.

Fifty-nine commenters generally favored NCUA's underserved area policies. Twelve additional commenters specifically favored updating the definition of an investment area. Most of these commenters believe this amendment will promote greater participation in serving underserved areas. Two commenters opposed the amendment. Both of these commenters appeared to misunderstand the statutory authority of NCUA to allow credit unions to serve underserved areas.

The NCUA Board is adopting the interim final rule in final with a minor modification. This final rule makes the Chartering Manual consistent with 2000 census data and the CDFI Fund's modifications. If the 2000 census data is not readily available for a particular category, the latest information from the Census Bureau may be used. In addition, the Board is permitting credit unions to submit other government data to demonstrate that an area is an investment area if this information is more readily available than census data. This alternative data must be issued after the year 2000. This one additional change along with the original amendments will ultimately make it easier for credit unions to add underserved areas and thus serve more members of modest means.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (those under one million dollars in assets). These final amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The NCUA Board has determined that this interim final rule does not increase, and will in fact reduce, paperwork requirements under the Paperwork Reduction Act and regulations of the Office of Management and Budget.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Public Law 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has determined that the provisions contained in IRPS 02–1 do not constitute a major rule.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule does not apply to state-chartered credit unions and will not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on April 18, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 790 and 792

Description of NCUA; Requests for Agency Action and Requests for Information under the Freedom Of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) Board approved its fiscal year 2002 budget at its November 15, 2002, board meeting. The fiscal year 2002 budget includes several changes to NCUA's central office structure that will reduce costs and improve efficiency at the agency. The changes involve the elimination of some offices and a transfer of the duties of those offices to either existing offices or the newly created Office of Strategic Program Support and Planning (OSPSP).

EFFECTIVE DATE: This rule is effective May 8, 2002.

FOR FURTHER INFORMATION CONTACT: Mary Rupp, Staff Attorney, Division of Operations, Office of General Counsel, (703) 518–6540, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

SUPPLEMENTARY INFORMATION: NCUA in conjunction with its fiscal year 2002 budget is restructuring its central office. This restructuring consists of: establishing an OSPSP; transferring the functions of the Office of Investment Services (OIS) and the Director of Strategic Planning (DSP) into OSPSP; transferring the functions of the Office of Administration (OA) to the Office of Chief Information Officer (OCIO), the Office of Public and Congressional Affairs (PACA) and the Office of the Chief Financial Officer (OCFO); and integrating the Office of Training (OTD) into the Office of Human Resources (OHR). The NCUA Board is amending parts 790 and 792 of its regulations, to conform them to the restructured central office. 12 CFR parts 790 and 792.

Regulatory Procedures

Final Rule Under the Administrative Procedure Act

The revisions made to this part are not subject to the notice and comment provisions of the Administrative Procedure Act (APA), 5 U.S.C. 551 *et seq.* The final rule revisions relate only to matters relating to agency management and personnel, topics exempt from APA requirements. 5 U.S.C. 553(a)(2).

Effective Date

NCUA also finds good cause to dispense with the 30-day delayed effective date requirement under sec. 553(d)(3) of the APA. The rule relates only to internal agency procedures and does not affect the public. The rule will, therefore, be effective immediately upon publication of this notice.

Regulatory Flexibility Act

An initial regulatory flexibility analysis under the Regulatory Flexibility Act is required only when an agency is required to publish a general notice of proposed rulemaking for any proposed rule. 5 U.S.C. 603. As noted previously, NCUA has determined that it is unnecessary to publish a notice of proposed rulemaking for this rule. Accordingly, an initial regulatory analysis is not required. Moreover, since this final rule imposes no new requirements and makes only housekeeping amendments, NCUA has determined and certifies that this rule will not have any significant economic impact on a substantial number of small credit unions (primarily those under $1 million in assets).

Small Business Regulatory Enforcement Fairness Act

Title II of the Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996 (Pub. L. 104–121) provides, generally, for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has reviewed this rule and has determined that for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 it is not a major rule.

Paperwork Reduction Act

NCUA has determined that the final rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) and regulations of the Office of Management and Budget.

Executive Order 13132 Statement

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

List of Subjects

12 CFR Parts 790 and 792

Credit unions.

By the National Credit Union Administration Board on April 29, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 703 and 704

Investment and Deposit Activities; Corporate Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is issuing final revisions to the rule governing corporate credit unions (corporates). The major revisions to the rule are in the areas of capital, credit concentration limits and services. The amendments enable corporates to remain competitive in the marketplace while retaining NCUA's historic focus on the safety and soundness of the corporate credit union system. The major changes to these areas necessitate some substantive changes to other provisions of the rule. Several other minor revisions are generally either a clarification or a modernization of the existing rule.

DATES: This rule is effective November 25, 2002, except that the revision of the definition ''paid-in capital'' in § 704.2 is effective July 1, 2003. Compliance with this rule is not required until January 1, 2003.

FOR FURTHER INFORMATION CONTACT: Kent Buckham, Director, Office of Corporate Credit Unions, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone (703) 518–6640; or Mary Rupp, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

On July 28, 1999, and November 22, 2000, NCUA issued advance notices of proposed rulemaking (ANPRs). 64 FR 40787, July 28, 1999; 65 FR 70319, November 22, 2000. Based on the comments received in response to the ANPRs, the Board issued a proposed rule. 66 FR 48742, September 21, 2001. In response to the comments received, particularly in the area of capital, the Board issued a revised proposed rule for another round of public comment. 67 FR 44270, July 1, 2002. The Board received 37 comments on the revised proposal: 22 from corporate credit unions, six from natural person credit unions, four from credit union trade associations, two from bank trade associations, two from state credit union leagues and one from a research firm. The commenters appreciated the Board's willingness to issue a revised proposal. The comments to the revised proposed rule have greatly assisted the Board in drafting the final rule and will be discussed in the relevant section of the section-by-section analysis.

B. Section-by-Section Analysis

Natural Person Credit Union Investments, Section 703.100

As in the initial proposed rule, the Board retained an increase in the limit on a natural person credit union's aggregate purchase of paid-in capital (PIC) and membership capital (MC) in one corporate to 2 percent of the credit union's assets measured at the time of purchase. Additionally, the Board retained the limit on a credit union's aggregate purchase of PIC and MC in all corporates of 4 percent.

Two commenters, both bank trade groups, noted continued opposition to the proposed increase. The commenters argued that it increases exposure to individual credit unions and raises the overall systemic risk. One commenter expressed support for the proposal but indicated the limit should be based on the natural person credit union's net worth rather than on its assets.

The Board remains convinced the revised limits on natural person credit union investments in PIC and MC in an individual corporate and in the aggregate are in the best interest of the credit union system. These changes have been retained in the final rule.

Definitions, Section 704.2

Daily Average Net Assets (DANA)

Although not specifically addressed in the rule, nineteen commenters continued to oppose the guidance on DANA issued by the Office of Corporate Credit Union (OCCU) in 2000 that was discussed in the preamble. Corporate Credit Union Guidance Letter No. 2000–03, August 30, 2000. The letter addressed the inclusion of future dated ACH items and uncollected cash letters that are perfectly matched on both the asset and liability sides of the balance sheet in the definition of DANA. As noted in the revised proposal, the issue is whether such transactions should be recorded on their settlement date (the date the funds are posted) or on the advice date (the date the corporate receives an advice indicating the funds will posted on a specific future date). 67 FR at 4270. All of the commenters on this issue noted their preference for recording these transactions on the settlement date.

The commenters stated that, while the American Institute of Certified Public Accountants (AICPA) has not taken an official position on this specific issue, there exists professional accounting guidance supporting exclusion of future dated ACH transactions from the definition of DANA. For example, the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concept's No. 6—Elements of Financial Statements defines liabilities as ''probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entitles as a result of past transactions or events.'' FASB No. 6 goes on to state that an item is not a liability ''if the item involves a future sacrifice of assets that the entity will be obligated to make, but the events or circumstances that obligate the entity have not yet occurred.'' A number of commenters indicated they are under no legal obligation to pay the transactions on the advice date. Several commenters also noted that some corporates have received opinions from their CPA firms indicating accounting for such transactions as of the advice date is not in accordance with Generally Accepted Accounting Principles (GAAP).

The Board believes it is important to have consistency among corporates, as well with the other financial regulators. To ensure NCUA's position on this issue is consistent with that taken by the other financial regulators, NCUA staff contacted the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision and the Federal Reserve Board. All of these financial regulators require their financial institutions to report future dated ACH transactions on their call reports as of the advice date. None of the financial regulators exclude future dated ACH transactions from their regulatory ratio calculations. As such, NCUA's position is consistent with the other financial regulators.

The Board remains convinced that a corporate should report future dated ACH items and uncollected cash letters on the advice date for both regulatory and 5310 (Corporate Credit Union Call Report) reporting purposes. For other financial statement reporting, corporates should follow their CPA firm's guidance.

Capital, Section 704.3

One commenter indicated the Board should not set a regulatory standard for each type of capital account, including retained earnings. The commenter suggests each corporate set its own limits for each type of capital it wants to hold. NCUA should just set a minimum overall capital level. Several commenters indicated that PIC should be counted equally with regular reserves and undivided earnings (RUDE) in all areas of the regulation.

One commenter recommended limiting the aggregate amount of MC and PIC that can be used to satisfy the total capital requirement to 100 percent of RUDE. One commenter indicated that the amount of MC that can be counted as ''core capital'' should be limited to 50 percent of retained earnings and PIC.

The Board is not persuaded to revise the treatment of the various capital accounts. The Board believes there is a very important distinction between internally generated capital, retained earnings, and other types of capital accounts. The Board continues to believe an adequate level of internally generated capital is essential to avoid erosion of member confidence in the event losses occur. The final regulation provides an adequate capital structure and appropriate types of capital accounts for corporates.

Requirements for Membership Capital, Section, 704.3(b)

The Board addresses the comments to this provision in conjunction with its discussion of the comments on Appendix A, Model Forms.

Requirements for Paid-in Capital, Section, 704.3(c)

One commenter suggested removing the prohibition conditioning membership, services, or prices for services on a credit union's ownership of PIC. The commenter indicated that PIC is no longer considered a temporary measure to strengthen capital, and the same restriction is not placed on MC. The Board continues to believe it is in the best interest of natural person credit unions and their members to be able to obtain the most efficient and cost effective services available. The Board does not want, in effect, to force natural person credit unions to commit to a long-term PIC account as a means of obtaining service or membership. PIC was intended to be an additional means for corporates to strengthen their levels of capital. The Board believes a natural person credit union's decision to invest in PIC should be based on its commitment to the corporate, not a requirement to obtain services. Forcing natural person credit unions to obtain PIC as a condition of membership may have the unintended consequence of having them seek products and services outside the system.

Fifteen commenters requested a ''grandfathering'' period ranging from 12 to 24 months on the implementation of the revised definition of PIC. While supportive of the change making PIC a perpetual, non-cumulative dividend account, the commenters believe that immediate adoption of the definition might give a competitive advantage to those corporates that issued PIC under the existing regulatory definition. Several commenters noted that some corporates held off issuing PIC to see what the regulatory changes were before dedicating the time and expense to that endeavor.

The Board views the issuance of PIC as a business decision for corporates. In response to the comments, the Board will permit corporates to issue PIC under the current definition of PIC until June 30, 2003. The effective date of the revised definition of PIC is delayed until July 1, 2003.

Earnings Retention Requirement, Section, 704.3(i)

Based on comments to the proposed rule, the Board in the revised proposal eliminated the requirement that established a minimum RUDE to moving DANA ratio of 2 percent. Three commenters opposed this action and requested the minimum RUDE ratio be reinstated.

In place of a minimum RUDE ratio, the Board proposed an earnings retention requirement. Five commenters indicated they supported the intent of the earnings retention requirement, but not the proposal in full. Seven commenters opposed the earnings retention requirement.

A number of commenters suggested the process for calculating the earnings retention ratio is virtually impossible because dividends are paid throughout the month on various accounts. Due to the timing of when financial statements are prepared, losses or expenses may not be fully appreciated until after dividends have already been paid. A corporate might pay dividends without realizing it had gone below the 2 percent level.

Four commenters indicated that PIC should be included with retained earnings in the earnings retention calculation. Another commenter suggested excluding the gains/losses on the sale of fixed assets and other non-operating gains/losses from the earnings retention calculation. One commenter suggested calculating the earnings retention requirement only on a quarterly basis, and another commenter suggested calculating on a year-to-year rather than month-to-month basis. One commenter believed that a total capital ratio alone would be sufficient for monitoring capital in corporate credit unions. Another commenter suggested that capital requirements for each corporate be based on the risk in that specific institution.

Twenty-seven commenters objected to the dividend restrictions in § 704.3(i)(5). Numerous commenters expressed concern that the dividend restrictions might give their competitors an advantage over credit union deposits. Many also expressed concern that natural person credit unions would seek riskier investments if they believed the corporate may be unable to pay dividends. This could result in a negative impact on the entire credit union system. Several commenters also noted that smaller natural person credit unions would be the most severely affected as they rely heavily on the dividends they earn from their deposits in corporates. Two commenters recommended that a corporate that falls below 2 percent be allowed to pay dividends, but be required to submit an earnings retention plan. Two other commenters objected to the dividend restrictions for state-chartered corporates because it moves control over undivided earnings out of the hands of the corporates and the state regulators and into the hands of the federal deposit insurer. One commenter noted that, even if NCUA were flexible in its approach to approving dividend payments, the perception of increased risk would have inflicted damage to the credit union network. Several commenters indicated that NCUA already has adequate regulatory and supervisory tools to ensure corporates build and maintain an appropriate level of capital.

Ten commenters recommended the adoption of a credit-risk weighted capital requirement as the best means of measuring capital in corporate credit unions.

The Board continues to believe that an earnings retention requirement is the appropriate means of ensuring adequate retained earnings on an ongoing basis. As noted in the preamble of the revised proposed rule, the Board is concerned that a minimum RUDE ratio may have the unintended consequence of limiting the traditional role of corporates as depositors of excess liquidity for natural person credit unions. The Board also believes, as stated numerous times in the past, that a credit-risk weighted capital requirement is not the best measure of risk in corporates. 67 FR at 44273.

The Board agrees failure to pay dividends would have a dramatic impact on a corporate, its members, and, potentially, the entire credit union system. The intent of proposed § 704.3(i)(5) was to ensure cooperative action between the corporate and NCUA and, if applicable, the state regulator in building retained earnings that have fallen below the minimum desired level. Therefore, the Board is persuaded that

§ 704.3(i)(5) should be revised to address the commenters' concerns while retaining the original intent of the proposed regulation. Any restriction on the payment of dividends has been eliminated from the final rule.

The final rule requires operational management of corporates to notify the board of directors, supervisory committee, OCCU Director and, if applicable, the state regulator if the retained earnings ratio falls below 2 percent. Notification of the occurrence is sufficient if the decrease in the retained earnings ratio is due solely to the increase in moving DANA and the dollar amount of retained earnings has remained constant or increased. This places no additional burden on a corporate that has an influx of funds due to excess liquidity in natural person credit unions.

If a corporate's retained earnings ratio declines below 2 percent due, in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 2 percent by the next month end, the corporate will be required to submit a retained earnings action plan.

The Board believes NCUA has sufficient supervisory authority over corporates, coupled with the notification and the retained earnings action plan requirements, to work with officials to address a decline in the retained earnings ratio below 2 percent in a timely and effective manner.

The Board is satisfied that the existing retained earnings ratio calculation method is sufficient. The timing of the notification within 10 calendar days is based on the date the determination is made that the retained earnings ratio has fallen below 2 percent. If necessary, the timing of the submission of a retained earnings action plan within 30 calendar days is based on the next month end after the month in which the retained earnings ratio has fallen below 2 percent. In some cases, the determination may be made during the month, while in other cases the determination may not be made until after the books are closed at the end of the month.

Board Responsibilities, Section 704.4

The revised proposed rule changed the term ''operating policies'' to ''policies'' throughout this section and changed the title of subsection (c) to ''Other requirements.'' The commenters supported this change and it has been retained as proposed.

Investments, Section 704.5

The revised proposed rule deleted several investment related definitions no longer used in the regulation and amended the definitions of: Asset-backed security (ABS), Collateralized mortgage obligation (CMO), Forward settlement, Quoted market price, Mortgage related security, Regular-way settlement, Repurchase transaction, and Residual interest. One commenter suggested including the acronym ''ABS'' in the title for asset-backed security. The Board agrees, and the final rule includes the acronym. No commenters objected to the other provisions, and they have been deleted or amended as proposed.

Two commenters expressed concern about possible erroneous categorizations of home equity backed securities on the 5310 Call Report in light of the revised definitions of mortgage related security and asset-backed security. If there is any uncertainty about appropriate reporting, a corporate is encouraged to discuss the matter with its corporate examiner.

One commenter suggested deleting the definitions of: Credit enhancement; Dealer bid indication; Industry recognized information provider; Matched; and Small business related security, if they are no longer used in the regulation. The Board agrees and is deleting the first four terms since they are no longer used but is retaining the definition of ''small business related security'' since that term is used in § 704.5(h)(4).

Policies, Section 704.5(a)

The revised proposed rule combined the policy requirements in this section and deleted ''if any'' from § 704.5(a)(1) to clarify a corporate must have ''appropriate tests and criteria'' to evaluate investments it makes on an ongoing basis, as well as new investments. No comments were received on these provisions, and they have been retained as proposed.

The revised proposed rule deleted the requirement in § 704.5(a)(2) that the investment policy address the marketing of liabilities to its members. No comments were received on this provision, and it is deleted in the final rule.

The revised proposed rule added a requirement for a corporate to establish appropriate aggregate limits on limited liquidity investments. As with the initial proposed rule, the revised proposed rule defined ''limited liquidity investment'' to mean an investment without a quoted market price. The preamble specified ''limited liquidity investment'' means ''a private placement or funding agreement.'' 67 FR at 44274, 44285.

One commenter did not object to the proposed definition and supported the proposed requirements for limited liquidity investments. Another commenter was concerned with the proposed definition. The commenter noted using the term ''quoted market price'' in the definition was problematic, since sales prices on most ABS and MBS are not publicly available and dealers do not post bid and asked quotes. The Board agrees and has revised the definition in the final rule so that it is consistent with the revised proposed preamble. The final rule limits ''limited liquidity investments'' to private placements and funding agreements. The requirements for limited liquidity investments are retained as proposed.

Authorized Activities, Section 704.5(c)(5). The revised proposed rule clarified an ABS must be domestically issued. No comments were received on this provision, and it is retained as proposed.

Section 704.5(c)(6). The revised proposed rule deleted this section, which provided specific authorization for CMOs. These investments are still authorized under § 704.5(c)(1) and (5). No comments were received on this provision, and it is deleted in the final rule.

Repurchase agreements, Section 704.5(d). The revised proposed rule made several changes to the requirements for repurchase agreements to conform them to current market practices. No comments were received on this provision, and it is retained as proposed.

Securities lending, Section 704.5(e). The revised proposed rule made several nonsubstantive changes to the requirements for securities lending transactions to clarify the rule and conform it more closely to current market practices. No comments were received on this provision, and it is retained as proposed.

Investment companies, Section 704.5(f). Section 704.5(f) of the revised proposed rule allows a corporate to invest in an investment company, for example, a mutual fund ''provided that the prospectus of the company restricts the investment portfolio to investments and investment transactions that are permissible for that corporate credit union.'' One commenter stated that the prospectus of an investment company does not restrict the investment portfolio of an investment company, and suggested that the quoted language be changed to read ''provided that all investments and investment transactions, as described in the prospectus of the company, are permissible for that corporate credit union.'' The Board appreciates the issue

the commenter raises but does not believe a change is necessary.

A mutual fund must file a registration statement with the Securities and Exchange Commission (SEC) on Form N–1A. The prospectus is Part A of Form N–1A. According to the SEC's instructions for completing Part A, the prospectus will ''describe the Fund's principal investment strategies, including the particular type or types of securities in which the Fund principally invests or will invest.'' SEC Final Rule, Registration Form Used by Open-End Management Companies (Item 4), 63 FR 13916, 13951, March 23, 1998.

To the extent that a prospectus for a particular mutual fund only discloses the securities it ''principally'' invests in, the fund might hold other investments that are impermissible for the corporate credit union. This is unacceptable. A corporate may not own investments indirectly through a mutual fund that it is prohibited from owning directly.

While the SEC's instructions on completing a prospectus do not require the prospectus disclose all permissible investment types, the instructions do not prohibit such disclosure either. Where the prospectus' description of investment types includes only investments permissible for corporates, and that it will not hold investments other than those described, the mutual fund will be permissible for the corporate.

The Board also notes that Part B of the registration statement, the Statement of Additional Information (SAI), provides additional information about the mutual fund's investment policies and permissible investment types. For example, the SAI will ''[d]escribe any investment strategies, *including a strategy to invest in a particular type of security,* used by an investment adviser of the [mutual] fund in managing the fund that are *not* principal strategies * * *.'' Final Rule, Registration Form Used by Open-End Management Companies (Item 12(b)), 63 FR 13916, 13956, March 23, 1998, (emphasis added). In addition, the SAI will ''[d]isclose, if applicable, the types of investments that a Fund may make while assuming [a temporary defensive position as described in the prospectus.]'' *Id.,* Item 12(d).

If a prospectus is not clear, a corporate should obtain the SAI on any particular mutual fund directly from the fund company. A fund's prospectus, when read in conjunction with the SAI, should provide sufficient information on the types of investments the fund may make and whether they are restricted to those permissible for the corporate.

Prohibitions, Section 704.5(h). The revised proposed rule permitted trading securities but required transactions to be accounted for on a trade date basis and, in addition, no longer prohibited engaging in pair-off transactions and when-issued trading. The revised proposed rule retained the prohibitions on engaging in adjusted trading and short sales. No comments were received on these provisions and they are retained as proposed in the final rule.

The revised proposed rule prohibited investments in residual interests in ABS, deleted the prohibition on commercial mortgage related securities, and moved the prohibition on the purchase of mortgage servicing rights from the investments section to the permissible services section. The Board notes that the prohibition on the purchase of mortgage servicing rights, as explained in the permissible services section, is being retained as an impermissible investment. One commenter agreed with the deletion of the prohibition on investments in commercial mortgage-related securities. The commenter noted the market for privately-issued commercial mortgage-related securities has become well-established in recent years. The Board agrees, and these provisions have been deleted or amended as proposed.

Credit Risk Management, Section 704.6

The revised proposed rule defined ''obligor'' to mean the primary party obligated to repay an investment and excluded from the definition the originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment. No comments were received on this definition, and it is retained as proposed.

The revised proposed rule deleted the definitions of ''short-term investment'' and ''long-term investment'' since they are no longer used. The revised proposed rule also deleted the definition of ''expected maturity,'' since that term was only used in the definitions of these deleted terms. No comments were received on these definitions, and they are deleted in the final rule.

Policies, Section 704.6(a). The revised proposed rule amended the policy requirements to base credit limits on capital, rather than RUDE and PIC. A few commenters supported this provision. This provision is retained as proposed.

The revised proposed rule deleted the requirement that the credit risk management policy address loan credit limits. The revised proposed rule added to the examples of concentrations of credit risk an ''originator of receivables'' and an ''insurer.'' No comments were received on these provisions, and they are retained as proposed.

Exemption, Section 704.6(b). The revised proposed rule required subordinated debt of government sponsored enterprises to meet the rule's credit risk management requirements. No comments were received on this provision, and it is retained as proposed.

Concentration limits, Section 704.6(c). The revised proposed rule established a general credit concentration limit of 50 percent of capital or a *de minimis* limit of $5 million for the aggregate of all investments in any single obligor, whichever is greater. One commenter, a bank trade group, asserted these changes would increase concentration limits. It claimed without explanation that the proposed 50 percent of capital limit would not have the overall effect of reducing credit concentration limits from the prior limits as stated in the preamble to the proposed rule. 67 FR at 44275. The Board disagrees. Using July 2002 month-end data for an unsecured obligation, the proposed 50 percent of capital limit, in comparison to the current limits, would decrease the corporate system's aggregate maximum investment in the unsecured obligations of a single obligor from $5.43 billion to $2.95 billion, reflecting a reduction in credit concentration of $2.48 billion. For secured obligations, there would be a large reduction because, unlike the revised proposal that had a limit of 50 percent of capital, corporates with Part I or Part II expanded authorities currently have no limitation.

Eleven commenters opposed the general credit concentration limit as too restrictive. Some commenters noted there is a relatively small number of AAA rated obligors. Thus, the proposed limits could force increased aggregate exposure to lower quality credits. A number of these commenters suggested a general credit concentration limit of 100 percent of capital on investments rated no lower than AA- (or equivalent) or A–1 (or equivalent). Two commenters recommended an increase to the credit concentration limit for investments rated AAA (or equivalent); one recommended a limit of 100 percent of capital. One commenter suggested differentiating between single obligor debt instruments and ABS or MBS, noting single obligor instruments, such as corporate debt instruments, are entirely dependent upon the performance of the issuing entity. Two commenters suggested NCUA generally reconsider the limits, with one suggesting NCUA permit a higher

percentage concentration limit for investments rated AA (double A flat) or higher.

As the Board noted in the revised proposed rule, the Board believes this 50 percent limit is the most credit exposure a corporate should prudently take in investment-grade quality investments. *Id.* The Board continues to believe the corporate network must exercise caution in placing membership capital at risk, and these provisions are retained as proposed.

Section 704.6(c)(2) of the revised proposed rule provided exceptions to the general credit concentration rule. For repurchase and securities lending transactions, the proposed limit was 200 percent of capital. Investments in corporate CUSOs were subject to the limitations in § 704.11. Investments in wholesale corporate credit unions and aggregate investments in other corporates were exempt. One commenter recommended limiting the exemption to wholesale corporates. The commenter asserted it was difficult to envision efficiencies for corporates investing in other non-wholesale corporates. As stated in the preamble to the revised proposal, the Board continues to believe that the benefits to the corporate system of applying this exemption to all corporates outweigh any potential concerns, and the Board is retaining the exemption in the final rule. 67 FR at 44275.

Revised proposed § 704.6(c)(3) deems an investment as ''nonconforming'' if it fails a credit concentration requirement because of a reduction in capital following the purchase of that investment. A corporate is required to exercise reasonable efforts to bring nonconforming investments into conformity within 90 days. Investments that remain nonconforming for 90 days are deemed to ''fail'' a requirement, and a corporate will have to comply with the requirements in § 704.10. No comments were received on this provision, and it is retained as proposed.

Two commenters recommended deleting § 704.6(c)(4), since proposed § 704.6(c)(3) addressed the same issue. The Board notes that § 704.6(c)(4) was deleted in the revised proposed rule and will remain deleted in the final rule.

Credit ratings, Section 704.6(d). This section reduced the applicable credit rating to AA- (or equivalent) for investments with long-term ratings and A–1 (or equivalent) for investments with short-term ratings. The revised proposed rule triggered the investment action plan requirements of § 704.10 if at least two ratings were downgraded and a corporate had relied on more than one rating to meet the minimum credit rating requirements at the time of purchase.

A state-chartered corporate supported this proposal, but believed additional investment authority was needed. The corporate noted its state supervisory authority permitted investment in all investment grade categories. Further, the commenter noted typical cash market practice for repurchase transactions is to require investment grade securities; the commenter noted it is more difficult to arrange repurchase agreements at favorable rates if the securities must be restricted to those with ratings in the top grades of the investment grade categories.

As noted in the preamble to the revised proposed rule, in light of the substantial flexibility already provided to corporates, the Board remains convinced a base level corporate should not be permitted to acquire more than limited credit risk exposure. Expanded authority provisions allow a broader spectrum of credit risk, and require increased due diligence by corporates that obtain such authority. 67 FR at 44276. Thus, this section is retained as proposed.

The proposed rule clarified investments in a corporate or a CUSO do not require a rating. One commenter recommended corporates be permitted to invest in other non-wholesale corporates only if that corporate had a credit rating from at least one nationally recognized statistical rating organization (NRSRO). It is not current market practice for corporates to obtain depositor ratings. While an NRSRO rating is a useful tool for investors to evaluate credit risk, it is no substitute for due diligence. The Board is convinced a corporate should be permitted to decide whether to purchase shares or deposits in another corporate. Thus, this provision is retained as proposed.

One commenter requested clarification of ratings relied upon ''at the time of purchase.'' The commenter noted this might mean either the trade or settlement date. The commenter asserted industry practice was to assign an assumed rating for new-issue securities and not to provide an official rating until settlement date. The commenter suggested there was the potential for a corporate to be unable to purchase new-issue securities until settlement date when the official rating was assigned if the interpretation of ''at the time of purchase'' were trade date. The Board agrees industry practice is to assign an assumed rating for new-issue securities and not to provide an official rating until settlement date. However, the Board understands it is also industry practice that purchase offers are contingent on assignment of the assumed rating. This means a purchasing corporate could refuse delivery on the settlement date if a security did not receive the bargained for rating. Thus, ''at the time of purchase'' means the security must have either an official permissible rating on the trade date if purchase is not contingent on receipt of an official permissible rating or, for a new issue, an assumed permissible rating on the trade date and an official permissible rating on the settlement date.

To avoid confusion regarding the investment watch list requirements of § 704.6(e)(1), the revised proposed rule clarified in § 704.6(d)(4) that it is applicable only when the corporate relied upon more than one rating to meet the minimum credit rating requirements at the time of purchase. If there is a subsequent downgrade below the minimum requirement, then the investment must be placed on the investment watch list.

One commenter recommended a technical change in § 704.6(d)(4) to delete the words ''any rating that'' following ''investment watch list'' and to substitute ''any investment for which a rating.'' The Board agrees, and the final rule reflects that substitution.

Reporting and documentation, Section 704.6(e). The revised proposed rule clarified that requirements for annual approval apply to each credit limit with each obligor or transaction counterparty. No comments were received on this provision, and it is retained as proposed.

Lending, Section 704.7

Section 704.7(c)(1) and (2). Currently, the aggregate secured and unsecured loan and line of credit limits to any one member credit union are based on the higher of a percentage of capital or a percentage of RUDE and PIC. The Board proposed basing the loan limits on a percentage of capital and eliminating the option of basing them on a percentage of RUDE and PIC. The Board received no comments on this section and has adopted this change in the final rule.

Section 704.7(c) and (d) and Appendix B to Part 704 reference ''irrevocable'' loans and lines of credit. In the revised proposed rule, the Board deleted the modifier ''irrevocable'' while clarifying in the preamble that the loan and line of credit limits apply to both ''irrevocable'' and ''revocable'' loans and lines of credit. One commenter objected to the deletion of the word ''irrevocable'' in the revised proposed rule. This commenter

suggested re-inserting either ''irrevocable'' or ''committed'' in the final rule so that the limits do not apply to uncommitted lines of credit. The Board's intent is that the aggregate limits apply to all loans and lines of credit and, therefore, the Board is retaining the deletion in the final rule.

Section 704.7(d). This section addresses ''Loans to nonmembers'' and is subdivided into two subsections: Credit unions and Corporate CUSOs. A commenter suggested part 704 should not distinguish between corporate and natural person credit union CUSOs. This commenter recommended expanding § 704.7 to address loans to natural person credit union CUSOs rather than requiring those loans to comply with part 723. The rationale was that the part 723 collateral requirements put corporates at a disadvantage in the marketplace for natural person credit union CUSO related activities. In the final rule, the Board does not expand § 704.7 to address loans to natural person credit union CUSOs. The Board believes that the exceptions should only apply to loan limits for corporate CUSOs because these entities are wholly or partially owned by corporates. Also, loans to corporate CUSOs are currently required to comply with part 723's aggregate limits and most of that regulation's due diligence requirements.

Section 704.7(e)(3). This provision of the revised proposal, like the current rule, provides a partial exemption from the member business loan rule if a loan or line of credit to an ''Other member'' is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. One commenter requested clarification as to whether cash or shares are also included as permissible collateral to secure a loan, line of credit or letter of credit. Loans secured by cash or shares, rather than qualifying for a partial exemption, are not member business loans and, therefore, are not subject to any of the requirements of part 723. 12 CFR 723.1(b)(2).

Revised proposed § 704.7(e) clarified the applicability of the member business loan rule in part 723 to loans granted by a corporate. The Board did not receive any comments on this revision and, therefore, the Board retained this clarification in the final rule.

Revised proposed § 704.7(g) expanded the provision governing loan participations between corporates to include a requirement that a corporate execute a master participation loan agreement before the purchase or the sale of a participation loan. In conjunction with this requirement, the Board deleted the language that a participation loan agreement may be executed at any time before, during, or after the disbursement. No comments were received on this section, and this requirement is retained in the final rule.

The Board proposed allowing corporates to participate in loans with member natural person credit unions but only as an expanded Part V authority and with certain limitations. One commenter indicated proposed Part V authority should be a permissible activity for all corporates. The rationale was that, since natural person credit unions are permitted to engage in this activity, it is not a regulatory concern for NCUA. This commenter also stated that state law on participation lending should govern state-chartered corporates. As stated in the preamble to the proposed rule, since the Board believes ''a number of corporates do not exhibit a level of infrastructure commensurate with the risks associated with this activity,'' corporates should apply for approval before entering into loan participations with natural person credit unions. 66 FR at 48748. For these reasons, the final rule only allows corporates with Part V authority to engage in participation lending with natural person credit unions. These safety and soundness concerns apply to state-chartered corporates as well as federal corporates. Another commenter recommended the Board grandfather corporates who have received a waiver to engage in participation lending with member natural person credit unions. The Board agrees and corporates with existing waivers continue to have the authority to enter into loan participations to the extent previously granted without applying for Part V authority.

One commenter recommended expanding Part V to permit a wholesale corporate to join with its member corporate in participating in a loan that the wholesale corporate is permitted to purchase in its own right from a nonmember natural person credit union. The Board believes it needs additional time to study this issue, which is being raised for the first time in response to the revised proposed rule. The Board notes that, after additional study, it may be open to considering this activity as permissible either by amending the regulation to expand Part V or as a waiver to Part V.

Finally, the Board proposed reorganizing the lending section to make it easier to read. No commenter objected to the reorganization and the final rule incorporates these changes.

Asset and Liability Management, Section 704.8

The revised proposed rule deleted the term ''net interest income'' because it is no longer used in the regulation and amended the definitions of ''net economic value (NEV)'' and ''fair value.'' NEV means the fair value of assets minus the fair value of liabilities. The amended definition excluded from liabilities both PIC and MC, rather than excluding only PIC. One commenter again urged that all off balance sheet financial derivatives remain in the definition of NEV. As the Board explained in the revised preamble, for purposes of NEV measurement, GAAP does not require accounting for immaterial positions in financial derivatives on balance sheets. 67 FR at 44277.

The commenter also recommended limiting the aggregate amount of MC and PIC included in total capital to not more than 100 percent of RUDE in any NEV-related requirements. This would limit the aggregate amount of MC and PIC excluded from liabilities for purposes of NEV calculations to not more than retained earnings, resulting in NEV limits based on a percentage of two times the fair value of retained earnings. If a corporate were to realize a loss of substantially all of retained earnings, but not MC or PIC, the commenter's proposal would require a corporate without net unrealized gains to eliminate all interest rate risk. The Board does not believe this is the most advisable course of action to re-establish earnings. Instead, the Board has proposed conservative NEV limits based on capital, rather than a subset of capital. Under the Board's formulation, a loss of substantially all of retained earnings reduces the level of interest rate risk permitted, but does not require a corporate to eliminate all interest rate risk. Therefore, these provisions are deleted or amended as proposed.

The Board has made a technical change to the revised proposed definition of ''fair value.'' In the first sentence of the definition ''other than in'' is changed to ''as opposed to.''

Policies, Section 704.8(a)(2). The revised proposed rule eliminated the redundancies with § 704.5(a) and changed the term ''current NEV'' to ''base case NEV'' to provide uniform usage throughout the regulation. No commenters addressed these provisions, and they are deleted or modified as proposed.

Section 704.8(a)(5). The revised proposed rule deleted the requirement for a policy limit on decline in net income. One commenter supported this

deletion, and it is deleted in the final rule.

Section 704.8(a)(6). The revised proposed rule added a requirement for the asset and liability management policy to address the tests used before purchase, to include an estimate of the impact of proposed investments on the percentage decline in NEV, as compared to the base case NEV. One commenter opposed this requirement. The commenter advocated the tests should be reviewed as a supervisory issue. As noted in the preamble to the revised proposed rule, this provision is intended to require a corporate to establish an ongoing process to identify, estimate, monitor and control interest rate risk between the periodic complete NEV analyses. 67 FR at 44277. The Board believes a corporate's board should establish policy parameters for this process and has retained this section as proposed.

Penalty for early withdrawals, Section 704.8(c). The revised proposed rule clarified that the minimum penalty for early certificate/share withdrawal, if early withdrawal is permitted, must be reasonably related to the rate that the corporate would be required to offer to attract funds for a similar term with similar characteristics. The preamble noted a gain does not appear consistent with the notion of a penalty for early withdrawal. 67 FR at 44278.

No commenters addressed the text of the revised proposed rule, however, nine commenters objected to the statement in the preamble that a gain does not appear consistent with the notion of a penalty for early withdrawal. *Id.* The commenters asserted a gain could be paid on early withdrawal of a share certificate and still meet the requirement of a penalty for early withdrawal. The commenters noted this is consistent with the ''mark to market'' premise of a penalty sufficient to cover the estimated replacement cost of the redeemed certificate. The commenters also noted the need to be competitive with alternative instruments that could provide members with liquidity and gains, without the need to increase the balance sheet of both the corporate and the member by a share secured loan if a gain could not be paid.

The Board does not believe that the concept of a penalty can be equated with the payment of a gain and reiterates that a gain is not permissible in conjunction with a penalty for early withdrawal. In addition, the Board is concerned that contractual provisions for redemption of a deposit at a gain may have the unintended consequence of encouraging a run on a substantially impaired corporate by members seeking to obtain gains. The Board acknowledges holders of debt securities may freely transact with third-party participants in the secondary market at a price that may result in a gain to the holder. However, debt security issuers typically are not subject to repurchase demands by debt holders. This is because the holder of a typical debt security does not have the right to put the debt to the issuer at a market price.

Interest rate sensitivity analysis, Section 704.8(d). The revised proposal deleted the requirement to conduct net interest income simulations. One commenter supported the elimination of the requirement for net interest income simulations, and it is deleted in the final rule.

The revised proposed rule deleted the word ''Treasury'' to permit evaluation of the impact of shocks in appropriate yield curves on its NEV and NEV ratio, since the market has moved away from the Treasury yield curve as a benchmark. No comments were received on this provision, and it is amended as proposed.

Section 704.8(d)(1)(i). The revised proposed rule increased from two to three percent the minimum base case NEV ratio that triggers monthly interest rate sensitivity analysis testing. One commenter suggested setting the trigger at four percent, rather than three percent, since the base case NEV ratio for most corporates will increase significantly because of the new definition of NEV.

The Board is comfortable with a three percent NEV trigger for monthly testing in base corporates, in large measure because the corporate system has improved its ability to identify, measure, monitor and control interest rate risk since the existing regulation was adopted. In addition, the estimation requirements of amended § 704.8(a)(6) typically provide adequate information for a base corporate with a minimum base case NEV ratio of at least three percent to monitor and control interest rate risk between complete periodic reevaluations. The Board recognizes base case NEV ratios are likely to increase substantially under the amended definition of NEV. The section is retained as proposed.

Section 704.8(d)(1)(ii) limited a corporate's risk exposure to levels that do not result in any NEV ratio resulting from the specified parallel shock tests, or a base case NEV ratio, of less than two percent, rather than the current one percent. No comments were received on this provision, and it is retained as proposed.

Section 704.8(d)(1)(iii). The proposal reduced the NEV decline limit for a base corporate from 18 to 15 percent. This represented an increased level of risk compared to the current rule, since the proposal excluded MCs from liabilities and, therefore, increased the base case NEV.

Two commenters recommended the Board retain the 18 percent limit: one noted this represented little interest rate risk and the other was not aware of any significant deterioration of a base corporate because of interest rate risk. In contrast, one commenter suggested reducing the NEV decline limit to 10 percent, to avoid increasing the amount of interest rate risk permitted.

As noted in the preamble to the revised proposed rule, the Board is comfortable with the increased risk because the corporate system has improved its ability to measure interest rate risk since the existing regulation was adopted. 67 FR at 44278. In addition, the estimation requirements of amended § 704.8(a)(6) provide adequate information for a corporate to monitor and control interest rate risk between complete periodic reevaluations. The Board does not believe it is prudent to increase the amount of interest rate risk that a base corporate may undertake further than the proposed 15 percent decline in NEV. Corporates meeting the requirements for expanded authority provisions are permitted to undertake additional interest rate risk. Thus, this section is retained as proposed.

Section 704.8(d)(2). The revised proposed rule required all corporates to assess annually whether it is appropriate to conduct periodic, additional, interest rate risk tests. These additional tests formerly were triggered based on the level of unmatched embedded options. No comments were received on this provision, and it is retained as proposed.

Regulatory Violations and Policy Violations, Section 704.8(e) and (f). The revised proposed changes were non-substantive, grammatical amendments and also designated the OCCU Director to respond to regulatory violations. No comments were received on these sections, and they are retained as proposed.

Divestiture, Section 704.10

The Board did not propose any changes to this provision; however, because of confusion concerning this provision, the Board proposed retitling it ''Investment Action Plan.'' This change clarifies that divestiture is not the only remedy available under this section. No commenters opposed the title change; however, five commenters objected to the current inclusion of derivative contracts under the

divestiture requirements of this section. They stated that these contracts are not investments and should not be subject to this provision. The commenters noted that these contracts are not freely tradable between third parties, as is the case with traditional investment instruments, and the cost for a corporate to ''unwind'' a derivative contract can be excessive.

The Board has consistently interpreted derivatives as subject to the requirements for investments. 12 CFR parts 703 and 704. Further, the Board believes these transactions should be subject to the requirements for an investment action plan because of the credit risk of the counterparty. Risk mitigation within the contract will have a significant impact on the Board's willingness to allow the corporate to hold instruments where the issuing entity has been downgraded. The Board is aware there are costs involved in unwinding a derivative contract and will review each plan submitted by a corporate weighing the costs of unwinding the derivative versus the risks associated with holding it. In addition, the Board has added clarifying language to Appendix B, Part IV to clarify how § 704.10 applies to derivative contracts. The Board remains convinced that corporates should not be allowed to hold financial contracts or investments from counterparties with excessive levels of credit risk and so will continue to interpret derivatives as investments under this provision. The Board is revising the title as proposed.

Corporate CUSOs, Section 704.11

The revised proposed rule added new due diligence requirements for corporates' loans to corporate CUSOs. These requirements were taken from the member business loan rule. No commenters commented on this provision and the Board is adopting it in the final rule.

The revised proposed rule maintains a limit of 15 percent of capital for investments in corporate CUSOs, increases the aggregate limit for loans and investments to 30 percent of capital, and retains the additional 15 percent for loans that are fully secured. One commenter objected stating the proposal was too limiting. Another commenter suggested clarifying that the 30 percent aggregate limit for loans and investments does not include the additional 15 percent for loans that are fully secured. The Board believes the increased limits strike the appropriate balance between added flexibility and safety and soundness and is retaining them as proposed in the final rule. The Board notes that the 30 percent aggregate limit does not include the additional 15 percent for loans that are fully secured.

The preamble to the revised proposed rule explained that the current audit requirements in § 704.11(d)(3) do not require a separate CPA audit for wholly owned CUSOs. This modification mirrored the practice that is currently permissible for natural person CUSOs. 63 FR 10743, 10747, March 5, 1998. Six commenters suggested that this exemption be stated in the regulation and it also apply to majority owned CUSOs. The Board agrees and the final regulation states that a wholly owned or majority owned CUSO is not required to obtain a separate annual audit if it is included in the corporate's consolidated audit.

Based on a request from six commenters, the revised proposal amended § 704.11(b) so that it mirrors § 712.6 of the natural person CUSO rule. Section 704.11(b) prohibits a corporate from acquiring control directly or indirectly of another ''financial institution'' and § 712.6 prohibits a natural person credit union from acquiring control directly or indirectly of another ''depository financial institution.'' One commenter questioned the authority of the Board to limit ''financial institution'' with the modifier ''depository.'' The Board's long-standing interpretation of financial institution is that it means a deposit taking institution. 51 FR 10353, 10354, March 26, 1986. This interpretation has been reflected in the natural person CUSO rule since 2001 and the Board believes adopting it in the corporate CUSO rule is appropriate. 66 FR 40575, August 3, 2001. This commenter also objected to the current prohibition on a corporate investing in the shares, stocks or obligations of a CUSO that is a financial institution. The commenter notes that this prohibition is broader than either the limitation in the Federal Credit Union (FCU) Act or the natural person CUSO regulation that only prohibit ''acquir[ing] control directly or indirectly'' and do not prohibit ''invest[ing]'' in a financial institution. 12 U.S.C. 1757(7)(I); 12 CFR 712.6. The Board agrees and is deleting this prohibition from the final rule.

The revised proposal clarified that the aggregate limit of § 723.16, the member business loan rule, applies to loans to CUSOs. No comments were received on this clarification and the Board is retaining it in the final rule.

Permissible Services, Section 704.12

The revised proposal listed eight broad categories of permissible financial services for corporates with examples under each category. This was modeled after the broad categories in parts 712 and 721. The Board received no comments on this provision, except as to its applicability to state-chartered corporates, and is retaining it in the final as proposed.

The revised proposal, at the commenters' suggestion, added a provision similar to the provisions in parts 712 and 721 concerning adding new permissible services. It permits corporates to petition the Board to add a new service to § 704.12 and encourages them to seek an advisory opinion from the Office of General Counsel (OGC) on whether a proposed service is already covered by one of the authorized categories before filing a petition. The rule does not require a corporate to come to OGC for an opinion every time it wants to provide a service not specifically listed as an example under a broad category. An opinion from OGC is recommended if there is doubt as to whether a specific service falls within one of the broad categories. In those situations, a corporate that does not consult with OGC runs the risk of engaging in an impermissible activity and being subject to supervisory action. Six commenters objected to or requested clarification on the applicability of this provision to state-chartered corporates. The commenters suggest that, at a minimum, since a state-chartered corporate's authority to engage in an activity is derived from its state statute and not the FCU Act, the appropriate approach for state charters is to request a waiver, rather than a rule change, to add an activity that may be impermissible for federal corporates. The Board would then base its decision to grant or deny the waiver on any safety and soundness concerns it has with the proposed activity. The Board agrees with the commenters and is revising the final rule to reflect a waiver process for state-chartered corporates.

The revised proposal deleted the requirement that services to nonmember natural person credit unions through a correspondent services agreement could only be provided to those natural person credit unions' branch offices in the corporate's geographic field of membership. In addition, the revised proposal clarified that a correspondent services agreement is an agreement between two corporates for one of the corporates to provide services to the members of the other. One commenter reiterated its objection to the clarification that correspondent services can only be provided through an agreement with another corporate credit union. The Board remains committed to the fundamental principle that credit

unions, including corporates, are formed to serve their members and is adopting the requirements in the revised proposal for correspondent services in the final rule.

The revised proposal also moved the current prohibition on the purchase of ''mortgage servicing rights'' from the investment section to this section and renamed it ''loan servicing rights.'' The Board has reconsidered removing this prohibition from the investment section. The Board will retain the prohibition in the investment section to clarify that this is not a permissible investment. It will also include the prohibition in this section. Although this activity is a permissible service for natural person credit unions under limited circumstances, the Board has safety and soundness concerns with corporates engaging in this activity, and will continue to prohibit this service for corporates.

One commenter suggested clarifying that the prohibition on the purchase of loan servicing rights does not apply if a corporate has the authority to purchase loans and the purchase of servicing rights are in conjunction with that purchase. The Board agrees that the purchase of servicing rights in conjunction with the purchase of a loan is not prohibited.

Fixed Assets, Section 704.13

The revised proposal eliminated this section. No commenters commented on this change. Therefore, the revised proposal reflects this change.

Representation, Section 704.14

The revised proposal clarified the meaning of the term ''credit union trade association'' in § 704.14(a) by adding to the regulation the definition of ''credit union trade association'' that was in the preamble to the prior final rule. 59 FR 59357, 59358, November 17, 1994. The thirteen commenters that commented on this clarification objected to adding a definition of ''credit union trade association.'' The commenters erroneously perceived this as a change and stated that it unnecessarily limited the pool of qualified applicants and is not needed in light of the recusal provisions in § 704.14(d). The commenters stated that the restrictive definition ignores the reality that natural person CEOs on corporate boards are often the most active in the credit union community serving multiple roles at the chapter, league and national level. Several of these commenters suggested amending the definition so that it is not so limiting. They suggested only including the state credit union leagues of the state in which the corporate is headquartered. One commenter fails to see how loyalty is divided if the chair serves on the board of an affinity group such as a defense, automotive or educational trade association. This commenter suggests only prohibiting state or multi-state leagues.

The Board continues to believe that the chairman of the board of a corporate should not serve simultaneously as an officer, director or employee of a national credit union trade association. As the Board stated when this provision was originally drafted, ''the chair should be an individual whose loyalty is *in no way divided* between the corporate credit union and a trade association.'' 59 FR 59357, 59358, November 17, 1994 (emphasis added). The Board, however, agrees that the definition is broader than is necessary to accomplish its objective of having a chair ''whose loyalty is in no way divided'' and is deleting from the prohibition ''and their affiliates and service organizations, and local, state, and national special interest credit union associations and organizations.''

The revised proposal amended the requirement in § 704.14(a) that both federal and state-chartered corporates comply with federal corporate bylaws governing election procedures. All corporates will have to comply with § 704.14(a) governing election procedures but state-chartered corporates will not have to comply with federal corporate bylaws. No commenters commented on this amendment. The Board is retaining this change in the final rule.

Wholesale Corporate Credit Unions, Section 704.19

The revised proposed rule eliminated the proposed 1 percent minimum RUDE ratio requirement and replaced it with an earnings retention requirement when the retained earnings ratio falls below 1 percent.

Three commenters addressed the earnings retention requirement. One commenter disagreed with the proposal stating despite the two-tier corporate structure, the earnings retention requirement should be the same as established for retail corporates. This commenter is concerned with the potential for a significant financial crisis in the credit union industry if a wholesale corporate fails. The Board remains convinced a separate wholesale corporate earnings retention requirement is appropriate based upon the corporate system's tiered capital structure.

One commenter expressed concern with the earnings retention requirement being met by either the current month or rolling 3-month calculation. This commenter believes wholesale corporates should be permitted to meet the earnings retention requirement based on a rolling 12-month average as presently permitted for reserve transfers. The Board believes sufficient flexibility for meeting the earnings retention requirement exists by using either the current month or rolling 3-month calculation. The Board notes the OCCU Director may approve a decrease in the earnings retention amount in the rare event a lesser amount is necessary to avoid a significant adverse impact upon a wholesale corporate.

One commenter stated the .15 percent per annum earnings retention requirement when the retained earnings ratio is less than 1 percent and the core capital ratio is less than 3 percent neither considers the tiering of reserves in the corporate system nor the narrow margins necessary for a wholesale corporate to offer competitive investment products. This commenter believes the earnings retention factor should be .10 percent per annum when the retained earnings ratio is less than 1 percent and the core capital ratio is less than 3 percent. The Board is not persuaded by this argument. The Board considers wholesale corporates subject to .15 percent per annum earnings retention requirement to be thinly capitalized. The Board believes wholesale corporates have numerous options available to reduce the earnings retention requirement if the .15 percent per annum earnings retention requirement is too onerous. For example, wholesale corporates can issue additional PIC to increase the core capital ratio to at least 3 percent or they can use off balance sheet activities to shrink their balance sheet.

Two commenters disagreed with the payment of dividend language in revised proposed § 704.19(b)(5) for many of the same reasons commenters opposed the language contained in revised proposed § 704.3(i)(5) for retail corporates. One commenter recommended substituting a notification provision for the current language. The Board agrees and, for the reasons stated in § 704.3, the final rule replaces the limitations on the payment of dividends with notification and restoration plan requirements.

Appendix A to Part 704—Model Forms

The revised proposal added language to the model forms to clarify the treatment of MC and PIC in the event of the merger, liquidation, or charter conversion of a member credit union or the corporate credit union. Six commenters raised objections to the

proposed clarifications. The commenters expressed concern that the additional requirements, rather than being a clarification to the existing language, alter the contractual agreement between the corporate and its members. A number of commenters also noted the additional language might create potential legal, regulatory, and operational problems. One commenter recommended leaving the added language in Appendix A and making the additional disclosure voluntary. Several commenters noted that natural person credit unions are not bound by part 704, nor is a continuing entity in the event of a charter conversion. Further, the commenters contended that, in the case of a liquidation or charter conversion, the member holding the MC or PIC account ceases to exist. As the entity no longer exists, its membership automatically terminates and its shares, including MC and PIC, should be paid out in accordance with applicable law. The commenters argued the model forms conflict with the Corporate Federal Credit Union Bylaws, and they may also conflict with applicable state laws for state-chartered credit unions. Several commenters indicated the existing language was adequate and it should be left up to each corporate to determine how to handle MC in the event of a merger, liquidation, or charter conversion based on its own capital management plan and applicable laws and regulations.

The Board does not believe the language added to Appendix A and to the requirements for MC in § 704.3(b)(3) create any additional legal, regulatory, or operational problems. The current regulation requires all MC accounts to have a minimum three-year notice. 12 CFR 704.2. The regulation does not provide any exceptions to the three-year notice requirement. The clarifying language has been added because OCCU has received inquiries as to how to handle MC in the event of merger, liquidation or charter conversion.

In the event of a merger, the existence of the MC should be identified as part of the due diligence process. The continuing credit union has the right to put the MC on notice. If the continuing credit union is a member of the corporate, an adjusted balance account may be adjusted at the next adjustment period. If the account is not an adjusted balance account, the continuing credit union would not be in violation of § 703.100, as that section specifically states the measure is assets ''*at the time of purchase*'' of the MC. In the event of a charter conversion, as with a merger, the existence and requirements of the MC should be identified during the due diligence leading up to a charter conversion. The new entity may place the MC on notice and collect the funds at the end of the three-year notice period. In the event of a liquidation, the Liquidating Agent may submit a request to the OCCU Director to allow the corporate to release the funds before the end of the three-year notice period.

The existing regulation is very specific that the only means by which a credit union may obtain its funds in an MC account is after the three-year notice or if it sells it to another credit union with the concurrence of the corporate. 12 CFR 704.2. The language was drafted to provide as much ''permanence'' to the three-year accounts as possible so they could be considered as capital. The regulatory requirements in the corporate rule and the contractual provisions of the MC concerning the three-year notice requirement do not conflict with the general provision in the Corporate Federal Credit Union Bylaws governing withdrawal of shares. Article III, Section 5 of the bylaws states a corporate's board may not require a member to give more than 60 days notice of intent to withdraw. This general withdrawal provision is not intended to apply to accounts that the member is contractually obligated to maintain for a period in excess of 60 days. Based on the requirements of current § 704.2, there should be no outstanding MC with conditions that would cause legal, regulatory, or operational concerns due to the addition of the clarifying language.

One commenter suggested revising the wording of § 704.3(b)(5) by changing the words ''credit union'' to ''another member'' to permit one member of the corporate to sell its MC to another member rather than only to a credit union in the corporate's field of membership. The Board concurs with the recommendation and has adopted this change in the final rule.

Appendix B to Part 704—Expanded Authorities and Requirements

In the revised proposed rule the Board proposed changes to: expand permissible credit ratings on investments; permit corporates that pre-commit to a higher level of capital the option of a higher level of interest rate risk; ease the requirements for corporates to participate in risk reducing derivative activities; and permit corporates to participate in loan participations with natural person credit unions. In addition, the revised proposal eliminated the proposed requirement for corporates to update the self assessment plan originally submitted for expanded authority. No comments were received objecting to the removal of this requirement and it is retained as proposed.

Base-Plus

In the revised proposed rule, the Board proposed a maximum NEV decline of 20 percent. Several commenters believed the limit should remain at its current 25 percent level, and one commenter believed the level should be decreased. The Board remains convinced that the proposed level is appropriate given the requirement of monthly NEV analysis. The Board is adopting the limits from the revised proposed rule.

Parts I and II

In the revised proposed rule, the Board proposed NEV decline limits based on capital levels. Several commenters opposed the proposed limits recommending the limits remain at current levels, and one commenter recommended lower levels. The Board has greater confidence in the ability of the corporate credit unions to model their balance sheets accurately; therefore, the limits were proposed at levels where the corporates can manage their balance sheets without taking excessive levels of risk. The Board was not convinced to change the levels either up or down; therefore, the Board is adopting the limits from the revised proposed rule.

The Board will permit any corporate currently approved for Part I or Part II Expanded Authorities to request to lower its NEV decline limit in conjunction with a request to lower its minimum capital requirement from 5 or 6 percent, respectively.

In the revised proposed rule, the Board proposed limits for the aggregate credit exposure to a single obligor at 50 percent of capital. Several commenters objected that the 50 percent of capital general concentration limit was too restrictive, particularly for corporates with expanded authorities. The commenters recommended increasing concentration limits to 100 percent, particularly for long-term instruments rated not lower than AA– and short-term investments rated no lower than A–1. The Board continues to believe this limit is the most credit exposure a corporate should prudently take in investment quality investments.

In the revised proposed rule, the Board established a 300 percent of capital limit for Part I, and 400 percent limit for Part II on aggregate investments in repurchase and securities lending agreements with any one counterparty. Several commenters objected to the

limits stating that these levels will significantly reduce their existing limits. The Board continues to believe the proposed levels are prudent given the secured nature of the activity and the increased requirements for credit analysis for Part I and II corporates; however, the Board believes increasing the limits beyond those proposed would raise safety and soundness concerns. The Board is adopting the limits as proposed in the revised proposed rule.

In the revised proposed rule, the Board tied minimum capital ratings of short-term investments to a minimum issuer long-term rating. One commenter contended that the requirement tying short-term and long-term ratings together is not representative of credit risks in the marketplace because long-term and short-term credit ratings should be assessed independently. The Board remains convinced that the overall credit quality of the issuer must fall within the limits of this rule and is adopting the proposed requirements.

Part II

The Board proposed lowering the minimum credit rating requirement for a long-term investment (including asset-backed securities) to BBB (flat). Three commenters recommended that BBB (flat) concentration limit be reduced to 25 percent and the concentration limit for AAA rated investments be increased to 100 percent of total capital. One commenter recommended the concentration limit for AAA rated investments be set at 75 percent for Part I and 100 percent for Part II. One commenter stated that corporates with higher levels of expanded authority have demonstrated the ability to manage the risks inherent in these lower rated instruments. The commenter also noted that corporates are in the business of managing risk. One commenter was opposed to permitting any investment in BBB (flat) rated securities. Based on the comments and further analysis of the risk, the Board believes the limit for BBB+ and BBB (flat) rated instruments with Part II authority should be reduced from the revised proposed rule level of 50 percent to 25 percent of capital. The Board agrees with the commenters that corporates with Part I or II authority do have additional credit monitoring capabilities allowing them to move down the credit scale and this authority requires the additional infrastructure stipulated in this rule and its appendixes.

Part III

In response to the proposed rule, several commenters noted that Part III granted preference to foreign banks over other foreign counterparties. The revised proposal permitted corporates to purchase investments from any approved entity with an acceptable NRSRO rating within a country with an acceptable country rating. This change allowed corporates greater flexibility in managing their investments. No comments were received and the Board is adopting this change as proposed.

In addition, the revised proposal incorporated the changes from the proposed rule. No comments were received and, for the reasons stated in the revised proposal, the Board is adopting these changes as proposed. 67 FR at 44283.

Part IV

Part IV expanded authorities have been restructured to provide more flexibility among corporates seeking to use derivatives to reduce risk. The current rule requires corporates to have either Part I or II expanded authorities to qualify for Part IV. The proposal removed this requirement. The Board believes that all corporates demonstrating and possessing the resources, knowledge, systems, and procedures necessary to measure, monitor, and control the risks associated with derivative transactions should be permitted to use these powers. As with all expanded authorities, the corporate in its application must detail the specific types of derivatives they may utilize. The Board believes that derivative transactions, used properly, reduce risk to the institution and its members.

In the revised proposed rule, the Board broadened the authority of corporates to enter into derivative transactions by adding government sponsored enterprises, member credit unions, and entities fully guaranteed by an entity with a minimum permissible rating for a comparable term investment. No negative comments were received, and the Board is adopting this change as proposed.

Several commenters noted that the revised proposed rule should state that Part III expanded authority was required for a corporate to enter into derivative contracts with a foreign counterparty. The Board has amended Part IV to clarify this.

In the revised proposed rule, Part IV (b)(1) detailed the requirements for counterparty credit ratings. Several commenters noted in their comments on § 704.10 that derivatives are not investments; therefore Section 704.10 should not apply. As previously stated, the Board has consistently interpreted derivatives as investments for purposes of parts 703 and 704. In addition, the Board believes that without credit mitigation within the contract, these instruments may present excessive levels of credit risk if a counterparty is downgraded. Therefore, Part IV is amended to clarify that compliance with § 704.10 is required if the counterparty is downgraded below permissible levels.

Delegations of Authority

Although not in the initial proposed rule, the Board, in an effort to streamline the regulatory approval process, has delegated to the OCCU Director in the revised proposal, the authority to act on its behalf in § § 704.3(e), (g) and (i); 704.8(e); 704.10; 704.15; and 704.19(b).

Technical Correction

The Board has revised the wording in § 704.18(e) to conform to the new terminology in part 704.

C. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under $1 million in assets). The rule only applies to corporates, all of which have assets well in excess of $1 million. The final amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final regulation does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget. NCUA currently has OMB clearance for part 704's collection requirements (OMB No. 3133–0129).

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The executive order states that: ''National action limiting the policymaking discretion of the states shall be taken only where there is constitutional and statutory authority for the action and the national activity is appropriate in light of the presence of a problem of national significance.'' The risk of loss to federally insured credit

unions and the NCUSIF caused by actions of corporates are concerns of national scope. The final rule will help assure that proper safeguards are in place to ensure the safety and soundness of corporates.

The rule applies to all corporates that accept funds from federally insured credit unions. NCUA believes that the protection of such credit unions, and ultimately the NCUSIF, warrants application of the proposed rule to all corporates, including nonfederally insured. The rule does not impose additional costs or burdens on the states or affect the states' ability to discharge traditional state government functions. NCUA has determined that this rule may have an occasional direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. However, the potential risk to the NCUSIF without the final changes justifies them.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. The regulatory change is understandable and imposes minimal regulatory burden. NCUA requested comments on whether the proposed rule was understandable and minimally intrusive if implemented as proposed. No comments were received.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget is reviewing whether this rule is a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR Part 703

Credit unions, Investments.

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements, Surety bonds.

By the National Credit Union Administration Board on October 17, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 722

Federal Credit Unions; Miscellaneous Technical Amendment

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is amending its appraisal regulation regarding the transaction value for nonresidential loans that require an appraisal from a state-certified appraiser. This amendment is technical rather than substantive.

DATES: This rule is effective November 4, 2002.

FOR FURTHER INFORMATION CONTACT: Chrisanthy J. Loizos, Staff Attorney, Division of Operations, Office of General Counsel, (703) 518–6540, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

SUPPLEMENTARY INFORMATION: When adopting the Regulatory Flexibility Program in 2001, NCUA amended its appraisal rule to raise the threshold for requiring an appraisal for real estate-related financial transactions from those over $100,000 to those over $250,000. 66 FR 58656, 58662, Nov. 23, 2001. NCUA also removed the provision creating a different threshold for appraisals related to member business loans. *Id.* The amendment, therefore, raised the appraisal threshold for all real estate-related financial transactions, including member business loans, to $250,000. The NCUA Board found that the raised appraisal threshold for a member business loan was consistent with the regulatory provisions adopted by the Federal banking agencies.

In the 2001 rulemaking, NCUA amended the transaction value threshold in paragraph (a)(1), the paragraph that requires certain types of transactions to have appraisals. 12 CFR 722.3(a). NCUA did not adjust the corresponding amount in paragraph (b)(2), the paragraph that determines the type of appraiser for certain nonresidential transactions, namely, member business loans. 12 CFR 722.3(b)(2). This has caused some confusion. Under paragraph (b)(2), only nonresidential transactions with a transaction value over $250,000 require an appraisal by a state-certified appraiser. 12 CFR 722.2(e), 722.3(a)(1), 722.3(b)(2). Some credit unions, however, have read the requirement in paragraph (b)(2) as requiring an appraisal for transactions with a value over $50,000.

This amendment conforms the transaction value that triggers the requirement for a state-certified appraiser's appraisal in paragraph (b)(2) to the transaction value threshold in paragraph (a)(1), which initially determines if the rule requires any appraisal. The amendment clarifies that a federally insured credit union must have an appraisal prepared by a state-certified appraiser for a nonresidential transaction if the value of the transaction exceeds $250,000.

Regulatory Procedures

Final Rule Under the Administrative Procedure Act

The amendment to the final rule is technical rather than substantive. NCUA finds good cause that notice and public comment are unnecessary under sec. 553(b)(B) of the Administrative Procedure Act (APA), 5 U.S.C. 553(b)(B).

Effective Date

NCUA also finds good cause to dispense with the 30-day delayed effective date requirement under sec. 553(d)(3) of the APA. The rule is technical rather than substantive. The rule will, therefore, be effective immediately upon publication of this notice.

Regulatory Flexibility Act

An initial regulatory flexibility analysis under the Regulatory Flexibility Act is required only when an agency is required to publish a general notice of proposed rulemaking for any proposed rule. 5 U.S.C. 603. As noted previously, NCUA has determined that it is unnecessary to publish a notice of proposed rulemaking for this rule. Accordingly, an initial regulatory analysis is not required. Moreover, since this final rule imposes no new requirements and makes only a technical amendment, NCUA has determined and certifies that this rule will not have any significant economic impact on a substantial number of small credit unions (primarily those under $1 million in assets).

Small Business Regulatory Enforcement Fairness Act

Title II of the Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996 (Pub. L. 104–121) provides, generally, for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has reviewed this rule and has determined that for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 it is not a major rule.

Paperwork Reduction Act

NCUA has determined that the final rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) and regulations of the Office of Management and Budget.

Executive Order 13132 Statement

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

List of Subjects in 12 CFR Part 722

Credit unions, Mortgages, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on October 15, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702, 741 and 747

Prompt Corrective Action

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: Pursuant to Congressional mandate, the National Credit Union Administration (NCUA) adopted a comprehensive system of prompt corrective action consisting of minimum capital standards and corresponding remedies to restore the net worth of federally-insured credit unions. After six quarters of implementation, the NCUA Board issued a proposed rule consisting of revisions and adjustments intended to improve and simplify the system of prompt corrective action. As revised to reflect public comments, the NCUA Board now issues a final rule incorporating these improvements.

DATES: Effective January 1, 2003.

FOR FURTHER INFORMATION CONTACT: *Legal:* Steven W. Widerman, Trial Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke St., Alexandria, VA 22314. Telephone: 703/518–6557; *Technical:* Jon Flagg, Loss/Risk Analysis Officer, Office of Examination and Insurance, at the address above. Telephone: 703/518–6378.

SUPPLEMENTARY INFORMATION:

A. Background
1. Development of Part 702
2. Where Credit Unions Stand Today
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B. Section-by-section Analysis of Final Rule
1. Section 702.2—Definitions
2. Section 702.101—Measure and effective date of net worth classification
3. Section 702.106—Standard calculation of RBNW requirement
4. Section 702.107—Alternative component for loans sold with recourse
5. Section 702.108—Risk mitigation credit
6. Section 702.201—PCA for ''Adequately Capitalized'' credit unions
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8. Section 702.205—Consultation with State officials on proposed PCA
9. Section 702.206—Net worth restoration plans
10. Section 702.303—PCA for ''Adequately Capitalized'' new credit unions
11. Section 702.304—PCA for ''Moderately Capitalized,'' ''Marginally Capitalized'' and ''Minimally Capitalized'' new credit unions
12. Section 702.305—PCA for ''Uncapitalized'' new credit unions
13. Section 702.306—Revised business plans for new credit unions
14. Section 702.401—Charges to the regular reserve
15. Section 702.403—Payment of dividends
16. Section 741.3—Adequacy of reserves
17. Section 747.2005—Enforcement of orders

The following acronyms are used throughout:

CUMAA Credit Union Membership Access Act
DSA Discretionary Supervisory Action
MBL Member Business Loan
MSA Mandatory Supervisory Action
NWRP Net Worth Restoration Plan
OCA Other Corrective Action
PCA Prompt Corrective Action
RBNW Risk-Based Net Worth
RBP Revised Business Plan
RMC Risk Mitigation Credit

Throughout the Supplementary Information section, citations to part 702 refer to the current version of 12 CFR 702 *et seq.* (2002) and are abbreviated to the section number only.

A. Background

1. Development of Part 702

In 1998, Congress enacted the Credit Union Membership Access Act (''CUMAA''), Pub. L. 105–219, 112 Stat. 913 (1998). CUMAA amended the Federal Credit Union Act (''the Act'') to require NCUA to adopt by regulation a system of ''prompt corrective action'' (''PCA'') consisting of minimum capital standards and corresponding remedies to improve the net worth of federally-insured ''natural person'' credit unions. 12 U.S.C. 1790d *et seq.* In February 2000, the NCUA Board adopted part 702 and subpart L of part 747, establishing a comprehensive system of PCA that combines mandatory supervisory actions prescribed by statute with discretionary supervisory actions developed by NCUA, all indexed to five statutory net worth categories. 65 FR 8560 (Feb. 18, 2000).

Subpart A of part 702 consists of standards for calculating a credit union's net worth and classifying it among five statutory net worth categories. 12 CFR 702.101–108. Also included in subpart A is a separate risk-based net worth (''RBNW'') component that applies to non-''new'' credit unions, § 702.102(a)(1)–(2), that satisfy minimum RBNW and asset size requirements, § 702.103, and whose portfolios of assets and liabilities carry above average risk exposure. § 702.104; 65 FR 44950 (July 20, 2000). Subpart B combines mandatory and discretionary supervisory actions indexed to the five categories, as well as PCA-based conservatorship and liquidation. § § 702.201–206. Subpart C consists of a system of PCA for ''new'' credit unions. § § 702.301–307. Subpart D prescribes reserve accounts, requirements for full and fair disclosure of financial condition, and prerequisites for paying dividends consistent with the earnings retention requirement in subpart B. § § 702.401–403. In addition to these substantive provisions, subpart L of part 747 established an independent review process allowing affected credit unions and officials to challenge PCA decisions. 12 CFR 747.2001 *et seq.* (2000).

Part 702 and subpart L of part 747 were effective August 7, 2000, and first applied to activity in the fourth quarter of 2000 as reflected in the Call Report for that period. The RBNW component of part 702 was effective January 1, 2001, and first applied (for quarterly Call Report filers) to activity in the first quarter of 2001 as reflected in the Call Report for that period.[1]

At the conclusion of the initial PCA rulemaking process, the NCUA Board directed the ''PCA Oversight Task Force'' (a working group consisting of NCUA staff and State regulators) to review at least a full year of PCA implementation and recommend necessary modifications. 65 FR at 44964. This final rule is the result of those recommendations, as modified to reflect public comments. The final rule takes effect January 1, 2003, and first applies to activity in the first quarter of 2003 as reflected in the Call Report for that period.

2. Where Credit Unions Stand Today

a. *Net worth classification.* As of June 30, 2002, federally-insured credit unions are classified as follows within the PCA net worth categories:

[1] Part 702 has since been amended twice—once to incorporate limited technical corrections, 65 FR 55439 (Sept. 14, 2000), and once to delete sections made obsolete by the adoption of a uniform quarterly schedule for filing Call Reports regardless of asset size. 67 FR 12459 (March 19, 2002).

TABLE A -- NET WORTH CLASSIFICATION OF NON-"NEW" FICUS

Statutory net worth category	*Net worth ratio*	*# of non-"new" FICUs*	*Percent of all non-"new" FICUs*
"Well Capitalized"	7% or greater	9382	96.49%
"Adequately Capitalized"	6% to 6.99%	231	2.38%
"Undercapitalized"	4% to 5.99%	83	0.85%
"Significantly Undercapitalized"	2% to 3.99%	17	0.17%
"Critically Undercapitalized"	Less than 2%	10	0.10%

TABLE B -- NET WORTH CLASSIFICATION OF "NEW" FICUS

"New" net worth category	*Net worth ratio*	*# of "new" FICUs*	*Percent of all "new" FICUs*
"Well Capitalized"	7% or greater	45	49.45%
"Adequately Capitalized"	6% to 6.99%	12	13.19%
"Moderately Capitalized"	3.5% to 5.99%	20	21.98%
"Marginally Capitalized"	2% to 3.49%	8	5.49%
"Minimally Capitalized"	0% to1.99%	7	7.69%
"Uncapitalized"	Less than 0%	2	2.20%

b. *RBNW requirement.* As of June 30, 2002, 448 federally-insured credit unions—4 percent of the total—were required to meet an RBNW requirement. Of these, 446 met the requirement using the ''standard calculation.'' § 702.106. The two that failed under the ''standard calculation'' succeeded in meeting their RBNW requirements using the ''alternative components.'' § 702.107. To date, no credit union has completely failed its RBNW requirement, and no credit union has applied for a ''risk mitigation credit.'' § 702.108.

3. Comments on Proposed Rule

On June 4, 2002, NCUA issued a proposed rule consisting of revisions and adjustments intended to improve and simplify the system of PCA. 67 FR 38431 (June 4, 2002). By the close of the comment period for the proposed rule, August 5, 2002, NCUA received 26 comment letters. Comments were received from seven federal credit unions, four state credit unions, eight state credit union leagues, two credit union industry trade associations, an association of state credit union supervisors, two banking industry trade associations, and a Federal Home Loan Bank. Nearly all of the comments supported the series of proposed revisions and adjustments to part 702.

This rulemaking will not address the few comments that suggested modifications to part 702 that exceed the scope of NCUA's statutory authority or that are completely unsupported. Comments on the concept of ''safe harbor'' approval of a net worth restoration plan are addressed in a separate proposed rule found elsewhere in this volume of the **Federal Register**. All other comments are analyzed generally in section B. below.

B. Section-by-Section Analysis of Final Rule

Part 702—Prompt Corrective Action

1. Section 702.2—Definitions

a. *Dividend.* Subpart D of part 702 sets various restrictions and requirements regarding the payment of dividends to members. §§ 702.403, 702.401(d), 702.402(d)(5). To extend these restrictions and requirements to interest that many State-chartered credit unions pay on shares and deposits, the proposed rule introduced a definition of ''dividend'' that included ''a payment of interest on a deposit by a State-chartered credit union.'' 67 FR at 38433. While one commenter supported the definition as proposed, two others pointed out that State-chartered credit unions pay interest on non-share deposits pursuant to a contractual obligation, and that restricting the payment of interest would cause a credit union to breach its deposit contract with the member. By comparison, dividends paid on shares entail no such contractual obligation. NCUA concurs with the commenters' point. Accordingly, the final rule omits the proposed definition of ''dividends'' and, further, eliminates the reference to ''interest'' in the discretionary supervisory action (''DSA'') restricting the payment of dividends. §§ 702.202(b)(3), 702.203(b)(3), 702.204(b)(3). As a result, the term ''dividends'' as used in part 702 excludes only those payments on shares and deposits that meet a statutory or other legal definition of contractual interest, regardless of the label a credit union gives to such payments.

b. *Senior executive officer.* Part 702 neglected to define who is a ''senior executive officer'' for purposes of the DSAs that authorize dismissing ''a director or senior executive officer,'' §§ 702.202(b)(7), 702.203(b)(8), 702.204(b)(8); hiring of a ''qualified senior executive officer,'' §§ 702.202(b)(8), 702.203(b)(9), 702.204(b)(9); and limiting compensation paid to a ''senior executive officer,'' §§ 702.203(b)(10), 702.204(b)(10). *See also* 12 CFR 747.2004(a) (review of dismissal of senior executive officer). To correct this oversight, NCUA proposed incorporating by reference the definition of a ''senior executive officer'' in 12 CFR 701.14(b)(2). 67 FR at 38433. Apart from a misquotation in the preamble to the proposed rule, the sole commenter supported the proposed definition. Accordingly, the final rule adds a new subsection (i) to § 702.2 that

incorporates by reference the definition of ''senior executive officer'' in 12 CFR 701.14(b)(2).

c. *Total assets.* The ''average quarterly balance'' definition of ''total assets'' was ambiguous as to whether the phrase ''[t]he average of quarter-end balances of the four most recent calendar quarters,'' § 702.2(j)(1)(i), refers to the four consecutive quarters *preceding* the then-current quarter, or to the then-current quarter *plus* the preceding three consecutive quarters. The proposed rule revised the definition to adopt the latter meaning. 67 FR at 38433. Apart from a misquotation in the preamble to the proposed rule, the two comments on the definition favored the latter meaning. Accordingly, the final rule redefines the ''average quarterly balance'' as the average of quarter-end balances of ''the current and three preceding calendar quarters.'' In addition, the final rule deletes the reference to semiannual first and third quarter Call Reports from the ''quarter end balance'' definition of ''total assets,'' § 702.2(l)(1)(iv), to reflect the adoption of a uniform quarterly schedule for filing Call Reports. 67 FR 12457 (March 19, 2002).

2. Section 702.101–Measures and Effective Date of Net Worth Classification

For nearly all credit unions, the effective date of net worth classification is the ''quarter-end effective date''—''the last day of the calendar month following the end of the calendar quarter.'' § 702.101(b)(1). Occasionally, however, an interim effective date between quarter-ends applies instead because ''the credit union's net worth ratio is recalculated by or as a result of its most recent final report of examination.'' § 702.101(b)(2). This typically results when an NCUA examination that takes place after the quarter-end effective date discloses that the credit union erred in calculating its net worth ratio and the corrected ratio puts it in a different net worth category. In that case, the date the credit union receives the final examination report becomes the new effective date of classification to the proper net worth category.

Several flaws have made it difficult to implement subsection (b)(2). First, it extended to instances where there was no error or misstatement in calculating net worth, but rather, data or conditions simply had changed since the date of the Call Report (which would be reflected in the next quarter's Call Report). Second, notice to the credit union to correct its net worth ratio had to await the ''most recent report of final examination'' even when an earlier supervision contact disclosed a calculating error or misstatement. Third, postponing such notice may deprive the credit union of the opportunity to take corrective action sooner. To rectify these flaws, the proposed rule revised subsection (b)(2) to define the effective date of classification to a ''corrected net worth category'' as ''the date the credit union receives subsequent written notice . . . of a decline in net worth category due to correction of an error or misstatement in the credit union's most recent Call Report.'' 67 FR 38434. NCUA received three comments on this section, all favoring these revisions. Therefore, the final rule adopts them as proposed.

3. Section 702.106–Standard Calculation of RBNW Requirement

The proposed rule suggested no modifications to the standard component for ''member business loans outstanding'' (''MBLs''). § 702.106(b). However, one commenter contended that the 12.25 percent risk-weighting threshhold in that component was arbitrarily based on CUMAA's restriction on member business lending, 12 U.S.C. 1757a(a)(2), and proposed that the threshhold be increased to 25 percent. After considering this suggestion, the NCUA Board has determined that the existing 12.25 percent threshold warrants reconsideration in connection with its review of the current MBL regulation, 12 CFR 723. Pending reconsideration, a credit union has two alternatives if it finds that the 12.25 percent threshhold distinguishes risk weightings among MBLs imprecisely. First, to resort to the corresponding alternative component for MBLs, § 702.107(b), which measures finer increments of risk among fixed- and variable rate MBLs. And second, to seek a risk mitigation credit, § 702.108, to moderate the impact of the standard risk-weightings. Accordingly, the existing 12.25 percent threshold is retained at this time.

4. Section 702.107–Alternative Components for Standard Calculation

a. *Alternative component for long-term real estate loans callable in 5 years or less.* For long-term real estate loans, part 702 features both a ''standard component'' and an ''alternative component'' for the RBNW calculation. §§ 702.106(a), 702.107(a). The longer the maturity of the loan, the greater the interest rate risk and credit risk exposure, justifying a correspondingly greater risk-weighting. *See* 65 FR at 44960–44961. Both components scheduled loans by contractual maturity date regardless whether there is a ''call'' feature permitting the lender to redeem the loan before the maturity date. The NCUA Board declined to propose scheduling ''callable'' loans by ''call'' date, rather than by maturity date, for reasons explained in the proposed rule. 67 FR at 38435. Instead, the NCUA Board suggested than an offsetting risk mitigation credit under § 702.108 was well suited to recognize when a credit union's program and history of efficiently exercising ''call'' options truly mitigates risk.

Six commenters objected that the NCUA Board's position denies them a reduced risk-weighting even though a ''call'' feature gives them the flexibility to shorten the term of real estate loans, thereby mitigating interest rate risk, and credit risk due to deterioration of the borrower's ability to repay or the collateral's value. One commended the ''call'' feature as a risk management tool. Another advocated allowing use of the ''call'' date, in lieu of the maturity date, on a credit union-by-credit union basis. And finally, a commenter recommended categorizing ''callable'' and non-''callable'' loans separately and assigning lower risk weightings to the ''callable'' category to reflect its reduced interest rate risk. In light of these comments, the NCUA Board has reconsidered its position and now recognizes that a ''call'' feature, when exercised in good faith, provides some measure of risk mitigation for real estate loans.[2]

Accordingly, the final rule expands the existing alternative component for ''long-term real estate loans'' to add a separate schedule for loans that are ''callable'' within a maximum period of 5 years. § 702.107(a)(2). The schedule consists of three maturity buckets that correspond to the buckets in the non-''callable'' schedule. *See* new Table 5(a) and new Appendixes C in rule text below. A loan that is ''callable'' within 5 years, and that has remaining maturity of less than 5 years, receives the same six percent risk-weighting that the existing alternative component gives to a non-''callable'' loan with a remaining maturity of less than 5 years. A loan that is ''callable'' within 5 years, and that has a remaining maturity of more than 5 years, receives a risk weighting that is two percentage points lower than the weighting for the corresponding non-''callable'' maturity bucket. To qualify

[2] The alternative component for MBLs continues to categorize MBLs by fixed- and variable-rate and then schedules the loans in each category for risk-weighting by remaining maturity. § 702.107(b). The NCUA Board is not scheduling MBLs by ''call'' date at this time out of concern for credit risk upon exercise of the ''call'' feature. However, this issue also may receive further consideration in connection with NCUA's review of the current MBL regulation, 12 CFR.

for the ''callable'' schedule, the ''call'' feature must be contractually specified in the loan documents and the credit union must maintain records documenting the breakdown of ''callable'' loans by maturity bucket.

b. *Alternative component for loans sold with recourse.* The standard component for loans sold with recourse assigns a uniform risk-weighting of 6 percent to the entire balance, § 702.106(f), regardless whether it includes loans sold with only *partial* recourse against the seller. Since part 702 was adopted, recourse loan activity among credit unions has nearly doubled, and loan programs have emerged that contractually limit the extent of the purchaser's recourse to the seller.[3] Thus, credit unions have gained the ability to cap their credit risk exposure from the sale of recourse loans.

In view of these developments, the proposed rule added a fourth alternative component to § 702.107 that would allow variable risk-weighting according to the actual credit risk exposure of loans sold with a contractual recourse obligation of less than 6 percent. 67 FR at 38434. The proposed alternative component is the sum of two risk-weighting buckets. The first bucket consists of the balance of loans sold with contractual recourse obligations of six percent or greater; it is risk-weighted at a uniform six percent. § 702.107(d)(1). The second bucket consists of the balance of loans sold with contractual recourse obligations of less than six percent; it is risk-weighted according to the weighted average recourse percent of its contents, as computed by the credit union.[4] § 702.107(d)(2); *see* new Table 5(d) and new Appendixes F and G in rule text below. Eight comments addressed the proposed ''alternative component'' for loans sold with recourse, all supporting it. Therefore, the final rule adopts the new alternative component in § 702.107(d) as proposed.

c. *Alternative component for short-term government obligations.* Although the proposed rule did not reference government obligations, a single commenter proposed an alternative component for government obligations with maturity of one year or less. Under the proposal, these obligations, up to a total equivalent to 25 percent of a credit union's total assets, would receive a zero risk weighting. The NCUA Board is unsympathetic to this proposal because the existing standard component for ''investments'' gives a risk-weighting of three 3 percent-half the six percent risk weighting assigned to average risk assets—to government obligations with a maturity of one year or less. § 702.106(c)(1). Government obligations are not completely risk free, as a zero risk-weighting suggests. On the contrary, they carry interest rate risk and transaction risk that justify a three percent risk weighting. Accordingly, the commenter's proposal is not adopted.

5. Section 702.108—Risk Mitigation Credit

Part 702 permits a credit union that fails an applicable RBNW requirement under both the ''standard calculation'' and the ''alternative components'' to apply for a ''risk mitigation credit'' (''RMC''). § 702.108(a). If granted, an RMC will reduce the RBNW requirement that must be met.[5] But NCUA will not consider an application for this relief until after the effective date that a credit union fails its RBNW requirement. *Submission Guidelines* § I.3. This forces a failing credit union to remain classified ''undercapitalized'' while its RMC application is pending, *id.* § § I.4, I.8, even when it reasonably expects to fail because it either failed or barely passed in a preceding quarter.

To spare credit unions that are genuinely in danger of failing an RBNW requirement from the ''fail first'' prerequisite, the proposed rule allowed them to apply for an RMC preemptively—that is, to apply in advance of the quarter-end so that the credit union receives any RMC for which it qualifies *before* the approaching effective date when it would fail its RBNW requirement. 67 FR at 38434. As revised, § 702.108 would allow a credit union to apply for an RMC at any time before the next quarter-end effective date if on any of the current or three preceding effective dates of classification it has either failed an applicable RBNW requirement, or met it by less than 100 basis points. An RMC granted preemptively would allow a credit union genuinely at risk of failing an RBNW requirement to seamlessly maintain its initial classification as either ''adequately capitalized'' or ''well capitalized.'' The nine commenters who addressed this endorsed the proposed relaxation of the RMC application prerequisites. Therefore, the final rule adopts the revisions to § 702.108 as proposed.

6. Section 702.201—PCA for ''Adequately Capitalized'' Credit Unions

a. *Earnings retention.* The proposed rule identified two flaws in the operation of the quarterly earnings retention requirement that applies to credit unions classified ''adequately capitalized'' or lower. First, that subsection (a) failed to specify that it is the dollar amount of net worth that must increase by the equivalent of 0.1 percent of assets per quarter, not the net worth ratio itself. (Changes in the net worth ratio will not match changes in the dollar amount of net worth unless net worth and total assets were to increase or decrease by exactly the same percentage.) Second, that subsection (a) technically does not allow credit unions to meet the statutory annual minimum transfer of the equivalent of 0.4 percent of total assets *on an average basis* over four quarters. As originally written, that subsection requires that the equivalent of 0.1 percent of assets be set aside in each and every quarter of the year, regardless whether the credit union has set aside more than the quarterly minimum in prior quarters.

To address both flaws, the proposed rule revised subsection (a) to specify that it is the ''the dollar amount'' of net worth that must be increased, not the net worth ratio itself, and to permit the minimum increase to be made ''either in the current quarter, or on average over the current and three preceding quarters.'' None of the commenters addressed these revisions. Therefore, the final rule adopts them as proposed.

b. *Decrease in retention.* Subsection (b) authorized NCUA, on a case-by-case basis, to permit a credit union to increase net worth by an amount that is less than the quarterly minimum (equivalent of 0.1 percent of assets) when necessary to avoid a significant redemption of shares and to further the purpose of PCA. § 702.201(b); 12 U.S.C. 1790d(e)(2). Since the adoption of part 702, however, some credit unions have decreased their quarterly earnings retention, either without seeking NCUA's permission at all, or prior to seeking NCUA's permission, in order to

[3] For example, documentation for the loan sale transaction may provide for recourse in the form of a contractually-specified recourse obligation measured either by a designated dollar amount that is fixed for the life of the loan, or by a designated percentage of the unpaid balance of a pool of loans.

[4] To caluate the ''weighted average recourse percent'' of the bucket of loans sold with recourse <6%, multiply each percentage of contractual recourse obligation by the corresponding balance of loans sold with that recourse to derive the total dollars of recourse. Divide the total dollars of recourse by the total dollar balance of loans sold with <6% recourse to derive the alternative risk weighting. *See* Appendix G in rule text below.

[5] To aid credit unions seeking a ''Risk Mitigation Credit,'' NCUA has released two publications: *Guidelines for Submission of an Application for PCA ''Risk Mitigation Credit''* (NCUA form 8507) *(''Submission Guidelines'')* and *Guidelines for Evaluation of an Application for PCA ''Risk Mitigation Credit''* (NCUA for 8508). The *Submission Guidelines* will be modified to reflect the revisions to § 702.108 adopted in this final rule.

pay dividends as they deem necessary. To prevent unilateral decreases in earnings retention, the proposed rule revised subsection (b) to add the requirement that a request to decrease earnings retention must be submitted in writing no later than 14 days before the quarter end. NCUA would be under no obligation to grant applications submitted after the 14-day deadline expires or after the quarter-end. Further, NCUA would be entitled to take supervisory or other enforcement action against credit unions that either decrease their earnings retention without permission, or persist in failing to timely apply for permission.

Two commenters advocated a more flexible approach—making the application period negotiable, and accepting verbal applications after the deadline, both on a case-by-case basis. The NCUA Board continues to believe that a documented request submitted within a ''bright line'' time frame is necessary for two reasons. First, to give credit unions clear notice of when they must apply for a decrease. Second, to facilitate uniform discipline of credit unions that unilaterally pay dividends without advance permission to decrease their earnings retention. A third commenter objected that a request to decrease earnings retention should not be required when a credit union is operating under an approved net worth restoration plan (''NWRP'') that projects quarterly earnings retention that is less than the minimum. *See* § 702.206(c)(1)(ii). In fact, a separate request for a decrease is not required under these circumstances because, as explained below, earnings retention is effectively subject to quarterly evaluation as a function of the NWRP. For these reasons, the final rule adopts the revisions to subsection (b) as proposed.

c. *Decrease by FISCU.* The requirement to ''consult and seek to work cooperatively'' with State officials when deciding whether a State-chartered credit union may decrease its earnings retention was originally located in § 702.205(c), where it was misidentified as a DSA. Because § 702.205(c) applies only to DSAs, the final rule relocates the ''consult and work cooperatively'' requirement to a new subsection (c) of § 702.201.

d. *Periodic review.* Part 702 provides that a decision permitting a decrease in earnings retention is ''subject to review and revocation no less frequently than quarterly.'' § 702.201(b); 12 U.S.C. 1790d(e)(2)(B). In practice, the ''no less frequently than quarterly'' timetable is too vague to indicate when such a review must take place. To coincide with the quarterly Call Reporting schedule that drives part 702, the proposed rule added a new subsection (d) to require uniform ''quarterly review and revocation,'' except when a credit union classified ''undercapitalized'' or lower is operating under an approved NWRP. NCUA received no comments on this modification.

For ''adequately capitalized'' credit unions (for whom earnings retention is the only MSA), quarterly review is implicit because a request to decrease earnings retention already must be renewed on a quarter-by-quarter basis. However, for credit unions classified ''undercapitalized'' or lower, separate quarterly review would be redundant when an approved NWRP is in place. To be approved, an NWRP must, in addition to prescribing quarterly net worth targets, § 702.206(c)(1)(i), project the amount of earnings retention, decreased as permitted by NCUA, for each quarter of the term of the NWRP. § 702.206(c)(1)(ii). Typically, approved NWRPs permit decreases in earnings retention extending for successive quarters over the term of the plan. These decreases are effectively subject to quarterly review and revocation as a function of the NWRP. A credit union that falls to a lower net worth category because it failed to implement the steps or to meet the quarterly net worth targets in its NWRP may be required to file a new NWRP, § 702.206(a)(3), thereby revoking the then-current NWRP approving future decreases in earnings retention. *See also* 12 CFR 747.2005(b)(3) (civil money penalty for failure to implement NWRP). In contrast, when a credit union *is* implementing the prescribed steps and meeting its net worth targets, there likely would be no reason to discontinue the decreased earnings retention approved in its NWRP.

Because quarterly review is effectively built-in to the NWRP, proposed new subsection (d) exempted credit unions operating under an NWRP from the quarterly review that § 702.201 imposes on ''adequately capitalized'' credit unions. NCUA received no comments on this exemption. Accordingly, the final rule adopts new subsection (d) as proposed.

7. Section 702.204—PCA for ''Critically Undercapitalized'' Credit Unions

a. *''Other corrective action''.* When a credit union becomes ''critically undercapitalized'' (net worth ratio <2%), part 702 gives the NCUA Board 90 days in which to either place the credit union into conservatorship, liquidate it, or impose ''other corrective action * * * to better achieve the purpose of [PCA].'' 12 U.S.C. 1790d(i)(1); § 702.204(c)(1). NCUA so far has interpreted the option to impose ''other corrective action'' (''OCA'') as requiring some further action in addition to complying with the steps prescribed in an approved NWRP for meeting quarterly net worth targets. Some further action would seem appropriate when a credit union either is not complying with its approved NWRP, or is implementing the prescribed action steps but still failing to achieve its quarterly net worth targets. But when a credit union has been both implementing the steps in its NWRP and timely achieving its net worth targets, demanding further action is superfluous, if not punitive. NCUA has found it difficult to fashion OCA that is more than a makeweight in these circumstances.

Congress left it entirely to the NCUA Board to ''take such other action'' in lieu of conservatorship and liquidation ''as the Board determines would better achieve the purpose of [PCA], after documenting why the action would better achieve that purpose.'' 12 U.S.C. 1790d(i)(1)(b). *See also* S. Rep. No. 193, 105th Cong., 2d Sess. 15 (1998). The NCUA Board has determined that the purpose of PCA—building net worth to minimize share insurance losses—is not undermined by declining to impose OCA when it is documented that a credit union already is achieving the purpose of PCA by complying with an approved NWRP and achieving its prescribed net worth targets. In other words, there would be no reason to demand more than complete success from a credit union that, so far, is completely successful in building net worth.

To implement a more flexible approach to imposing OCA in lieu of conservatorship and liquidation, the proposed rule revised subsection (c)(1)(iii) to provide that ''[OCA] may consist, in whole or in part, of complying with the timetable of quarterly steps and meeting quarterly net worth targets prescribed in an approved [NWRP].'' § 702.204 (c)(1)(iii). This would permit, but not require, NCUA to limit OCA to directing a credit union that already is in compliance with its approved NWRP to simply continue to comply, without undertaking any further action beyond what the NWRP already requires. NCUA received two comments; both supported this shift in approach to implementing OCA. Accordingly, the final rule adopts revised subsection (c)(1)(iii) as proposed.

b. *10-day appeal period.* The NCUA Board's authority to decide whether to

conserve a ''critically undercapitalized'' credit union, liquidate it, or allow OCA may be delegated only in the case of credit unions having assets of less than $5 million. 12 U.S.C. 1790d(i)(4); § 702.204(c)(4). In such cases, the credit union has a statutory ''right of direct appeal to the NCUA Board of any decision made by delegated authority.'' *Id.* However, neither the Act nor part 741 sets a deadline by which a credit union must appeal a delegated decision to the NCUA Board. The lack of a deadline for exercising the right to appeal delegated decisions to the NCUA Board gives ''critically undercapitalized'' credit unions at least the appearance of an unlimited opportunity to challenge a Regional Director's decision.

To impose similar finality upon the unfolding timetable of decisions that starts when a credit union becomes ''critically undercapitalized,'' the proposed rule revised subsection (c)(4) to set a deadline of ten calendar days in which to appeal a delegated decision. Objecting that 10 days is too few for small credit unions with unsophisticated management, the one commenter who addressed this section advocated a 30-day appeal period instead. However, the final rule adopts the proposed 10-day appeal period for two reasons. First, it parallels the 10-day window that the Act provides for seeking judicial review of any statutory conservatorship or liquidation. 12 U.S.C. 1786(h)(3), 1787(a)(1)(B). Second, a longer appeal period would unreasonably delay the payout of shares to members that must promptly follow a liquidation.

c. *Insolvent FCU.* The NCUA Board generally must liquidate a credit union eventually if it remains ''critically undercapitalized.'' § 702.204(c). Independently of PCA, however, the Act directs that ''[u]pon its finding that a Federal credit union * * * is insolvent, the Board shall close such credit union for liquidation.'' 12 U.S.C. 1787(a)(1)(A). Therefore, in the case of a ''critically undercapitalized'' *federal* credit union that is insolvent (*i.e.*, has a net worth ratio of less than zero), NCUA has the option of an insolvency-based liquidation. To clarify that this option is available, new subsection (d) to § 702.204 provides that ''a 'critically undercapitalized' federal credit union that has a net worth ratio of less than zero percent (0%) may be placed into liquidation on grounds of insolvency pursuant to [§ 1787(a)(1)(A)].''

8. Section 702.205—Consultation With State Officials on Proposed PCA

As explained above in reference to new subsection (c) of § 702.201, a cross-reference in § 702.205(c) misidentified the decision whether to permit a decrease in a FISCU's quarterly earnings retention as a DSA. To correct this error, the final rule deletes the erroneous cross-reference and relocates the ''consult and seek to work cooperatively'' requirement in § 702.201(c).

9. Section 702.206—Net Worth Restoration Plans

a. *Contents of NWRP.* Section 702.206 prescribes the contents of an NWRP that must be submitted for approval by credit unions classified ''undercapitalized'' or lower.[6] Among the items an NWRP must address is how the credit union will comply with MSAs and DSAs. § 702.206(c)(1)(iii). Some credit unions that were *not* subject to a DSA interpreted that requirement as a demand either to consent to a DSA, or to explain prospectively how the credit union *would* comply with DSAs if the NCUA Board were to impose any. The proposed rule revised subsection (c)(1)(iii) to clarify that an NWRP need only address whatever DSAs, if any, the NCUA Board *already* has imposed on the credit union. The one commenter who addressed this revision supported it. The final rule adopts revised subsection (c)(1)(iii) as proposed.

b. *Publication of NWRP.* Publication of an NWRP is not a prerequisite to enforcing its provisions as authorized in 12 CFR 747.2005, but this fact is not expressly stated in § 702.206 itself. The omission has led some to assume that an NWRP, like a ''Letter of Understanding and Agreement,'' must be published in order to subsequently be enforceable. The Act mandates that a ''written agreement or other written statement'' must be published in order for a violation to be enforceable ''unless the Board, in its discretion, determines that publication would be contrary to the public interest.'' 12 U.S.C. 1786(s)(1)(A). To the extent an NWRP qualifies as a ''written agreement or other written statement'' under § 1786(s)(1)(A), the NCUA Board does not intend to publish NWRPs because it has determined that publication would expose the credit union to reputation risk that would be contrary to the public interest. Therefore, the proposed rule added new subsection (i) to § 702.206, clarifying that ''An NWRP need not be published to be enforceable because publication would be contrary to the public interest.'' NCUA received two comments on the clarification and both supported it. Therefore, the final rule adopts new subsection (i) as proposed.

c. *Alternative capital.* The proposed rule did not reference subsection (e), which permits consideration of any ''regulatory capital'' a credit union may have in evaluating an NWRP. Nonetheless, NCUA received three comments urging the adoption of some form of alternative capital not only to be considered in evaluating an NWRP, but also to offset an applicable RBNW requirement. A fourth commenter opposed alternative capital in any form. The final rule does not address these comments because this rulemaking was not intended by the NCUA Board to be a forum for exploring or introducing alternative forms of capital.

10. Section 702.303—PCA for ''Adequately Capitalized'' New Credit Unions

Under the original alternative system of PCA for new credit unions, a credit union that managed to become ''adequately capitalized'' while still new was subject to the same minimum earnings retention that applies to non-new credit unions that are ''adequately capitalized.'' [7] § 702.201(a). In contrast, ''new'' credit unions that stayed classified below ''adequately capitalized'' were not subject to minimum earnings retention; they had to increase net worth only ''by an amount reflected in the credit union's approved initial or revised business plan.'' § 702.304(a)(1). This created a disincentive for a ''new'' credit union to become ''adequately capitalized'' because the reward for keeping its net worth ratio below 6 percent is that it is relieved from complying with a minimum earnings retention amount.

To eliminate the disincentive, the proposed rule put all new credit unions having a net worth lower than 7 percent in parity for purposes of earnings retention. 67 FR at 38437. An ''adequately capitalized'' new credit union would no longer be subject to the same minimum earnings retention as a non-new counterpart. Instead, like new credit unions in lower categories, it would be required to increase net worth quarterly by ''an amount reflected in its

[6] As noted earlier in this preamble, the comments on the concept of ''safe harbor'' approval of an NWRP are addressed in a separate proposed rule found elsewhere in this volume of the **Federal Register.**

[7] The final rule corrects the wording of § 702.303, which inadvertently extended that section to ''new'' credit unions classified lower than ''adequately capitalized.'' Sections 702.304 and 702.305 continue to prescribe PCA for new credit unions in those net worth categories.

approved initial or revised business plan'' until it becomes ''well capitalized.'' In the absence of such a plan, however, the credit union would remain subject to the same quarterly minimum earnings retention as non-''new'' credit unions.

Two commenters supported parity among new credit unions for earnings retention purposes. Advocating a far less flexible approach, a third commenter (a banking industry trade association) objected that exempting any new credit unions from the statutory minimum earnings retention is not in accordance with CUMAA. That commenter overlooks the fact that CUMAA applies a minimum earnings retention requirement to non-new credit unions; it prescribed no earnings retention requirement at all for new credit unions. 12 U.S.C. 1790d(e)(1). Instead, CUMAA gave NCUA discretion in developing an alternative system of PCA, provided that it recognized that new credit unions initially have no net worth; need reasonable time to accumulate net worth; and need incentives to become ''adequately capitalized'' by the time they no longer qualify as ''new.'' 12 U.S.C. 1790d(b)(2)(B). *See* 64 FR 27090, 27098 (May 18, 1999) (justification for flexible approach). It is entirely consistent with this last statutory criterion to eliminate any disincentive—such as *minimum* earnings retention—for a new credit union to reach ''adequately capitalized'' while it is still ''new.''

11. *Section 702.304—PCA for ''Moderately Capitalized,'' ''Marginally Capitalized'' and ''Minimally Capitalized'' New Credit Unions*

As explained above, the final rule modifies § 702.201(a) to specify that earnings retention must increase the ''the dollar amount'' of net worth, not simply the net worth ratio itself. To conform to that modification, § 702.304(a)(1) is revised accordingly.

12. Section 702.305—PCA for ''Uncapitalized'' New Credit Unions

a. *Member business loan restriction.* Part 702 originally gave an ''uncapitalized'' new credit union full relief from all MSAs while it was operating within the period allowed by its initial business plan to have no net worth. § 702.305(a). An unintended consequence of this forbearance was that ''uncapitalized'' credit unions were free of the MSA restricting MBLs; that restriction applied only when a credit union managed to attain *some* net worth and rise to the ''minimally capitalized'' net worth category.[8] Yet a ''minimally capitalized'' credit union arguably is better suited to expand its MBL portfolio than one that remains ''uncapitalized.'' Further, making PCA *more* demanding as a credit union's net worth and category classification improve, rather than relaxing it, is contrary to the purpose of PCA. To rectify this unintended consequence, the proposed rule extended subsection (a) to include an ''uncapitalized'' new credit union that is operating with no net worth as permitted by an initial business plan. 67 FR at 38437. As a result, ''uncapitalized'' new credit unions are all subjected to the MBL restriction, § 702.305(a)(3), regardless whether they are operating with no net worth under an initial business plan, or have declined to ''uncapitalized'' after reaching a higher net worth category. NCUA received no comments on this section. Accordingly, the final rule adopts revised subsection (a) as proposed.

b. *Filing of revised business plan.* Subsection (a)(2) generally required an ''uncapitalized'' new credit union to submit a revised business plan (''RBP'') within 90 days following either of two events—expiration of the period that the credit union's initial business plan allows it to operate with no net worth, or the effective date that it declined to ''uncapitalized'' from a higher net worth category. This contrasts with the 30-day period that ''moderately capitalized,'' ''marginally capitalized'' and ''minimally capitalized'' credit unions are given to file an RBP. § 702.306(a)(1). Ninety days is an unduly long filing period given that an ''uncapitalized'' credit union faces mandatory conservatorship or liquidation if it fails to increase net worth to at least two percent. Furthermore, it is counterintuitive to give a credit union that *has* a net worth deficit three times as long to devise a plan for generating positive earnings than is given to credit unions that already have net worth.

The proposed rule put all new credit unions that must file an RBP in parity. First, it deleted the 90-day filing window for ''uncapitalized'' credit unions, thereby limiting them to the general 30-day window, once they are required to file an RBP. 67 FR at 38438. Second, it reorganized subsection (a)(2) to parallel the conditions that trigger other less than ''adequately capitalized'' new credit unions to revise their business plans, § 702.304(a)(2), even though only ''uncapitalized'' credit unions are initially allowed to operate with no net worth. To that end, the proposed rule required an ''uncapitalized'' credit union to submit an RBP if it either: fails to increase net worth (*i.e.*, reduce its earnings deficit) as its existing business plan provides; has no approved business plan; or has violated the MSA restricting MBLs.

The sole commenter on this topic supported the 30-day window for filing an RBP, while also urging NCUA to relieve the burden on new credit unions by providing assistance in preparing RBPs. *See* § 702.307(a) (assistance in preparing RBPs). For the reasons set forth above in this section, the revisions to subsection (a)(2) are adopted as proposed.

c. *Liquidation or conservatorship if ''uncapitalized'' after 120 days.* Subsection (c)(2) generally required the NCUA Board to conserve or liquidate an ''uncapitalized'' new credit union that remains ''uncapitalized'' 90 days after its RBP is approved. It was silent, however, regarding conservatorship or liquidation of a credit union whose RBP is rejected. To correct this oversight, the proposed rule mandated conservatorship or liquidation of an ''uncapitalized'' new credit union after a 120-day period regardless whether an RBP has been approved or rejected. 67 FR at 38438. This period combines the 30-day window for submitting an RBP, § 702.306(a)(1), and the original 90-day period allowed for the credit union to develop sufficient positive earnings to avoid conservatorship and liquidation. The 120-day period runs from the later of either the effective date of classification as ''uncapitalized'' or, if a credit union is operating with no net worth in the period prescribed by its initial business plan, the last day of the calendar month after expiration of that period. Because the period for operating with no net worth typically runs on a quarterly basis, the last day of the calendar month after it expires parallels the calendar month that separates the quarter-end and the effective date of classification as ''undercapitalized.''

NCUA received no comments on the revisions to subsection (c)(2) and, therefore, they are adopted as proposed. In addition, the final rule relocates to a new subsection (c)(3) the existing exception to mandatory conservatorship or liquidation for a credit union that is able to demonstrate that it is viable and has a reasonable prospect of becoming ''adequately capitalized.''

d. *''Uncapitalized'' new FCU.* As explained above in reference to new subsection (d) of § 702.204, there are two options for liquidating a federal

[8] The earnings retention requirement, § 702.305(a)(1), is ineffective against an ''uncapitalized'' credit union because a credit union that *has* an undivided earnings deficit has no net worth to retain.

credit union that has no net worth—a PCA-based liquidation, 12 U.S.C. 1787(a)(3)(A)(ii), or an insolvency-based liquidation. 12 U.S.C. 1787(a)(1)(A). Both are available when a new *federal* credit union either fails to timely submit an RBP, § 702.305(c)(1), or remains ''uncapitalized'' 120 days after the effective date of classification, § 702.305(c)(2). To clarify that this option is available, the final rule adds new subsection (d) to § 702.305, providing that ''an 'uncapitalized' federal credit union may be placed into liquidation on grounds of insolvency pursuant to [§ 1787(a)(1)(A)].''

13. Section 702.306 Revised Business Plans for New Credit Unions

a. *Filing schedule.* Subsection (a)(1) required ''moderately capitalized,'' ''marginally capitalized'' and ''minimally capitalized'' credit unions to file an RBP within 30 days after failing to meet a quarterly net worth target prescribed in an existing business plan. As discussed above, the final rule eliminates the 90-day filing window for ''uncapitalized'' credit unions. § 702.305(a)(2). To conform to that modification, the final rule also modifies subsection (a)(1) to apply the 30-day filing window uniformly to all new credit unions classified less than ''adequately capitalized'' or that have violated the MSA restricting MBLs. § § 702.304(a)(3), 702.305(a)(3).

The original rule's 30-day filing period ran from ''the effective date (per § 702.101(b)) of the credit union's failure to meet a quarterly net worth target prescribed in its then-present business plan.'' § 702.306(a)(1). Even as revised, however, § 702.101(b), which addresses the effective date of classification among the net worth categories, says nothing to determine when a quarterly net worth target is met. The subtlety of this distinction may confuse credit unions that have no then-present approved business plan or have violated the MSA restricting MBLs. Therefore, the proposed rule further revised subsection (a)(1) to effectively give new credit unions that fail to meet a quarterly target 60 days following the quarter-end to file an RBP. § 702.306(a)(1)(i). The 60-day period combines the calendar month that separates the quarter-end from the effective date of classification, with the uniform 30-day filing period that commences on the effective date. Finally, the proposed rule revised subsection (a)(1) still further to clarify that, for new credit unions that either have no approved business plan or that have violated the MBL restriction, the effective date of classification as less than ''adequately capitalized'' triggers the 30-day window for filing an RBP. § 702.306(a)(1)(ii)–(iii). NCUA received no comments on the revisions to the filing schedule for RBPs. Accordingly, revised subsection (a)(1) is adopted as proposed.

b. *Timetable of net worth targets.* Subsection (b)(2) prescribed the contents of an RBP, which must include a timetable of quarterly net worth targets extending for the term of the plan ''so that the credit union becomes 'adequately capitalized' and remains so for four consecutive quarters.'' It also warned that a ''complex'' new credit union that is subject to an RBNW requirement may need to attain a net worth ratio higher than 6 percent to become ''adequately capitalized.'' The proposed rule rectified two flaws in this section. First, in contrast to an NWRP, the objective of an RBP is to build net worth so that a new credit union becomes ''adequately capitalized'' by the time it no longer is ''new,'' [9] rather than by the end of the term of the plan. 65 FR at 8578; 64 FR 27090, 27099 (May 18, 1999) (chart). The proposed rule revised subsection (b)(2) so that an RBP's net worth targets ensure the new credit union will become ''adequately capitalized'' by the time it no longer qualifies as ''new.'' 67 FR at 38438. Second, under part 702 new credit unions cannot be ''complex'' or subject to an RBNW requirement because, by definition, they do not meet the $10 million asset minimum. § 702.103(a)(1). Therefore, the proposed rule deleted the warning to new credit unions that are ''complex.'' NCUA received no comments on either of these revisions. Accordingly, revised subsection (b)(2) is adopted as proposed.

c. *Publication of RBP.* As explained above, the final rule adds a new subsection (i) to § 702.206, to clarify that publication of an NWRP is not a prerequisite to enforcing its provisions as authorized in 12 CFR 747.2005. The same is true of an RBP, but this fact was similarly omitted from § 702.306. To the extent an RBP qualifies as a ''written agreement or other written statement'' under 12 U.S.C. 1786(s)(1)(A), the NCUA Board does not intend to publish RBPs because it has determined that publication would expose the credit union to reputation risk that would be contrary to the public interest. Therefore, the final rule adds new subsection (h) to § 702.306, clarifying that ''An RBP need not be published to be enforceable because publication would be contrary to the public interest.''

13. Section 702.401 Charges to Regular Reserve

a. *Regular reserve.* Although the proposed rule did not reference subsection (b), which requires credit unions ''to establish and maintain a regular reserve account,'' four commenters criticized it as obsolete. The NCUA Board prefers to retain the regular reserve at this time primarily for two reasons. First, it facilitates the statutory earnings retention requirement, 12 U.S.C. 1790d(e), by holding the earnings that credit unions classified ''adequately capitalized'' or lower are required to ''set aside.'' § 702.201. And second, it continues to function as an early warning signal of safety and soundness problems because, as explained below, regulatory review and approval is required before a credit union can take certain actions—charging losses to, and paying dividends from, the regular reserve—that would cause its net worth to decline below 6 percent.

b. *Minimum net worth to charge losses without approval.* Subsection (c)(1) originally allowed the board of directors of a federally-insured credit union that had depleted the balance of its undivided earnings and other reserves to charge losses to the regular reserve account without regulatory approval so long as the charge did not reduce the credit union's net worth classification below ''well capitalized'' (*i.e.*, net worth ratio of 7 percent or greater). § 702.401(c)(1). That net worth category was established as the minimum for charging losses without regulatory approval because the categories below ''well capitalized'' trigger MSAs. However, the proposed rule lowered the minimum category to ''adequately capitalized'' (*i.e.*, 6 percent net worth ratio) in order to give credit unions the flexibility to decide for themselves whether charging losses is worth triggering the single MSA that applies to that category—the quarterly earnings retention. § 702.201(a); 67 FR at 38439. In addition, the proposed rule expressly reminded credit unions that they must deplete their undivided earnings balance before making any charge to the regular reserve. All seven of the commenters who addressed these proposed revisions supported them. Thus, revised subsection (c)(1) is adopted as proposed.

c. *Dual approval to charge losses.* Subsection (c)(2) originally required the prior approval of the ''appropriate State official,'' but not the approval of the ''appropriate Regional Director,'' when a

[9] A credit union remains ''new'' as long as it is in operation less than 10 years and has assets of $10 million or less. 12 U.S.C. 1790d(o)(4); § 702.301(b).

State-chartered credit union seeks to charge losses that would cause it to decline below the minimum category. Omitting the approval of NCUA Regional Directors was inconsistent with the protocol applied elsewhere in part 702 requiring joint State and Federal approval of PCA decisions affecting State-chartered credit unions. *E.g.,* § § 702.206(a)(1), 702.306(a)(1). To correct this inconsistency, the proposed rule modified § 702.401(c)(2) to require the concurrence of both the ''appropriate State official'' *and* ''the appropriate Regional Director'' to permit a State-chartered credit union to charge losses to the regular reserve. In addition, the proposed rule clarified that written approval may consist of an approved NWRP that allows such charges.

The sole commenter on the revisions proposed for subsection (c)(2) objected that the dual approval requirement would unnecessarily overburden NCUA with the oversight of State officials. On the contrary, the NCUA Board does not consider its approval to be a function of overseeing State officials. Rather, its approval for a State-chartered credit union to charge losses to the regular reserve is integral to PCA because of NCUA's independent role as insurer of the shares and deposits of federally-insured State-chartered credit unions. Accordingly, revised subsection (c)(2) is adopted as proposed.

15. Section 702.403—Payment of Dividends

a. *Minimum net worth to pay dividends without approval.* Subsection (b)(1) originally allowed the board of directors of a federally-insured credit union that had depleted the balance of undivided earnings to pay dividends out of the regular reserve account without regulatory approval so long as it did not cause the credit union to decline below ''well capitalized.'' § 702.403(b)(1). As explained above in regard to § 702.401(c)(1), the proposed rule similarly lowered to ''adequately capitalized'' the minimum net worth category in which credit unions may pay dividends out of the regular reserve without regulatory approval. This would give credit unions that have depleted undivided earnings the flexibility to decide for themselves whether drawing down the regular reserve to pay dividends is worth triggering the quarterly earnings retention requirement that applies to ''adequately capitalized'' credit unions. § 702.201(a).

b. *Dual approval to pay dividends.* As with § 702.401(c)(2) discussed above, subsection (b)(2) originally required the prior approval of the ''appropriate State official,'' but not the approval of the ''appropriate Regional Director,'' when paying dividends out of the regular reserve would cause a State-chartered credit union to decline below the minimum net worth category. In addition, omitting Regional Director approval may suggest, incorrectly, that a State official's approval to pay dividends from the regular reserve under § 702.401(b) makes it unnecessary to independently obtain both the State official's and the Regional Director's approval under § 702.201(b) for a State-chartered credit union to decrease its earnings retention in order to pay dividends. For this reason and the reason explained in the preceding section, the proposed rule corrected this omission by revising subsection (b)(2) to require the concurrence of both the ''appropriate State official'' *and* ''the appropriate Regional Director'' for a State-chartered credit union to pay dividends out of its regular reserve. In addition, the proposed rule clarified that written approval may consist of an approved NWRP that allows such dividend payments. The two commenters who addressed the revisions proposed for subsections (b)(1) and (b)(2) supported them. Accordingly, they are adopted as proposed.

Subpart A of Part 741—Requirements for Insurance

16. Section 741.3—Adequacy of Reserves

Subsection (a)(2) originally allowed State-chartered credit unions to charge losses other than loan losses to the regular reserve in accordance with State law or procedures, but without regulatory approval, provided that the charges did not cause the credit union to decline below ''well capitalized.'' 12 CFR 741.3(a)(2). The preceding subsection (a)(1) incorporates by reference all of part 702 as a prerequisite for insurability of State-chartered credit unions. As discussed above, § 702.401(c) already imposes on State-chartered credit unions the same conditions for regulatory approval that subsection (a)(2) prescribes for an insured credit union seeking to charge losses to the regular reserve. Because this makes subsection (a)(2) redundant, the final rule eliminates it from § 741.3.

The final rule's removal of subsection (a)(2) does not mean that § 702.401(c) preempts ''either state law or procedures established by the appropriate State official'' that restrict a State-chartered credit union's ability to charge losses to the regular reserve. On the contrary, such charges would independently remain subject to applicable State laws and procedures. Further, an appropriate State official would retain complete discretion to withhold approval of such charges, under § 702.401(c)(2), on grounds that they would violate State law or procedures.

Subpart L of Part 747—Issuance, Review and Enforcement of Orders Imposing PCA

17. Section 747.2005—Enforcement of Orders

The NCUA Board is authorized to ''assess a civil money penalty against a credit union which fails to implement a net worth restoration plan * * * or a revised business plan under * * * part 702.'' 12 CFR 747.2005(b)(2). As explained above, the NCUA Board has determined that it is not in the public interest to require publication of an NWRP or an RBP in order for either to be enforceable and § § 702.206 and 702.306 are modified accordingly. The final rule makes a conforming modification to § 747.2005(b)(2) to provide that a civil money penalty may be assessed for failure to implement a plan ''regardless whether the plan was published.''

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis describing any significant economic impact a proposed regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The proposed rule improves and simplifies the existing system of PCA mandated by Congress. 12 U.S.C. 1790d. The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions and, therefore, a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The reporting requirements in this final rule have been submitted to the Office of Management and Budget. Under the Paperwork Reduction Act of 1995, no person is required to respond to a collection of information unless it displays a valid OMB number. Control number 3133–0161 has been issued for part 702 and will be displayed in the table at 12 CFR part 795.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on State and local interests.

NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily adheres to the fundamental federalism principles addressed by the executive order. This final rule will apply to all federally-insured credit unions, including State-chartered credit unions. Accordingly, it may have a direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. This impact is an unavoidable consequence of carrying out the statutory mandate to adopt a system of prompt corrective action to apply to all federally-insured credit unions. NCUA staff has consulted with a committee of representative State regulators regarding the impact of the proposed revisions on State-chartered credit unions. Their comments and suggestions are reflected in the proposed rule.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act, 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule.

List of Subjects

12 CFR Parts 702 and 741

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 747

Administrative practices and procedures, Credit unions.

By the National Credit Union Administration Board on November 21, 2002.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its rule that permits a federal credit union (FCU) to provide reasonable retirement benefits to its employees and officers. The amendments clarify the scope of the rule and the investments an FCU may use to fund employee benefits.

DATES: This final rule is effective May 30, 2003.

FOR FURTHER INFORMATION CONTACT: Frank Kressman, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

NCUA issued a proposed rule in December 2001 to clarify that the scope of § 701.19, which states an FCU may provide reasonable retirement benefits for its employees and officers, is not limited only to retirement benefits, but is more broadly applicable to other employee benefit plans. 66 FR 65662 (December 20, 2001). The proposal incorporated into § 701.19 a number of opinions issued by NCUA's Office of General Counsel that provide an FCU may purchase an otherwise impermissible investment to fund an employee benefit obligation if the investment is directly related to the obligation, and may hold the investment for as long as it has an actual or potential obligation. This direct relationship requirement is the legal basis on which NCUA permits FCUs to make otherwise impermissible investments to fund employee benefits. NCUA received fifteen comments to the proposal. The comments were generally supportive, but raised investment issues relating to particular benefit plans.

NCUA issued a second proposal in September 2002 to address these issues and others raised outside of the rulemaking process. 67 FR 60184 (September 25, 2002). The second proposal distinguished defined contribution plans from various kinds of defined benefit plans. In the second proposal, NCUA was particularly concerned about FCUs investing to fund defined benefit plans as these plans place investment performance risk on FCUs and make it more difficult for FCUs to demonstrate a direct relationship between an investment and the obligation it serves to fund.

NCUA distinguished defined benefit plans covered by the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 (ERISA) from those that are not. 29 U.S.C. 1101–14. NCUA determined that the ERISA requirements, which provide for a trust and place obligations on the trustee to act prudently on behalf of plan participants and beneficiaries, would safeguard against the legal and safety and soundness risks about which NCUA is concerned. For defined benefit plans not covered by ERISA's fiduciary responsibility provisions, NCUA proposed that investments to fund these plans must have a fixed rate of return, mature on or before the date of the employee benefit obligation, and be rated by a nationally recognized statistical rating organization in one of the four highest rating categories. NCUA believed that these broad criteria would support the determination that an investment is directly related to the employee benefit it is intended to fund and, in addition, address the safety and soundness concerns presented by these otherwise unrestricted investments.

NCUA extended the expiration of the comment period from November 25, 2002 to December 26, 2002. 67 FR 71113 (November 29, 2002).

B. Summary of Comments to the Second Proposed Rule

NCUA received twenty-six comment letters regarding the second proposed rule: nine from FCUs, one from a state credit union, thirteen from credit union trade organizations, one from an insurance company, one from a corporate credit union and one from a law firm. Five commenters expressed complete support for the proposal and did not object to any provisions. All but a few of the remaining commenters expressed general support for NCUA's intent to provide flexibility to FCUs investing to fund employee benefits. Commenters focused primarily on two aspects of the second proposed rule: the requirement that any investments purchased under this authority must be directly related to an FCU's obligation to fund employee benefits and the particular requirements proposed for defined benefit plans.

Directly Related Requirement. Some commenters stated that the requirement that an investment to fund an employee benefit be directly related to the FCU's obligation is new or would be too restrictive for certain employee benefit plans. This requirement was stated in the first proposal as well as the second proposed rule. While the particular terminology may be different, this requirement is not new for FCUs. As noted previously, this provision incorporates into the regulation NCUA's long standing position as reflected in legal opinions issued by NCUA's Office of General Counsel.

These legal opinions state NCUA's view that FCUs have the authority to purchase investments otherwise impermissible under the Federal Credit Union Act and NCUA's regulations if the investments are intended to fund an employee benefit. This requisite relationship is the legal basis, as has been previously discussed, which permits these investments. These legal opinions have addressed specific proposed retirement or benefit plans, for the most part defined contribution plans, and have focused on various criteria such as the reasonableness of the benefit in relation to the credit union's size and financial condition. In addition, these letters have noted that the ability of an FCU to make these otherwise impermissible investments is based on the legal premise that an FCU is not investing for its own account and is subject to restriction, such as the investments may only be held for as long as an FCU has an obligation under the retirement or benefit plan. For this reason, NCUA has declined to adopt alternative language proposed by a couple of commenters that an investment need only be reasonably related to an employee benefit. That language could arguably permit an FCU to make larger than necessary investments or hold investments longer than necessary to meet the employee benefit obligation, which would indicate an FCU was investing for its own account. The requirement in the regulation that investments must be directly related to the employee benefit obligation is intended to capture prior legal analysis and state simply and succinctly the requirements applicable to investments made to fund employee benefits.

While some commenters would like NCUA to specify the types of records or record keeping that would demonstrate that an investment is directly related to funding an employment benefit, NCUA is reluctant to impose specific requirements given the broad range of employee benefit plans and funding options that exist. NCUA believes that, if an FCU is holding an otherwise impermissible investment to fund an employee benefit, the FCU's records should reflect that the FCU purchased the investment exclusively for the purpose of funding the employee benefit obligation. Information in an FCU's

records that would demonstrate this purpose might include: employee benefit plan documents, date or dates of investment purchases consistent with the assumption of the employee benefit obligation, anticipated maturity of the investment, and evidence that the FCU has calculated the amount of the investment and the anticipated return from the investment to match the FCU's obligation.

Defined Benefit Plans. Half of the commenters stated that prohibiting variable rate investments to fund defined benefit plans not subject to ERISA is too restrictive. About the same number also stated or implied NCUA has ample authority to regulate the safety and soundness of these investments through its examination and supervision program. Ten commenters contended that, if FCUs are subject to additional investment restrictions, they will have higher costs of funding employee benefits and will be at a disadvantage in competing for talented employees with state-chartered credit unions and other financial institutions.

The NCUA Board has decided not to distinguish between defined benefit and defined contribution plans in the final rule or place additional requirements on defined benefit plans not covered by ERISA. Thus, all employee benefit plans will be subject to the general requirements set out in both the first and second proposed rules, namely, that an investment to fund an employee benefit must be directly related to the FCU's obligation, may only be held as long as the FCU is obligated, and the amount must be reasonable given the size and condition of the FCU. NCUA believes this approach will maximize investment flexibility and minimize confusion and competitive disadvantage for FCUs.

NCUA still believes, as noted in the second proposal, that defined benefit plans not subject to ERISA pose additional risks for FCUs and, for that reason, has included in the regulation guidance regarding diversification of investments. NCUA believes an FCU investing to fund a defined benefit plan not subject to ERISA should diversify its investment portfolio, which may include investments in insurance products, to minimize the risk of large losses, unless it is clearly prudent not to do so under the circumstances.

Regardless of what kind of investment plan is used, an FCU must comply with safety and soundness standards by ensuring that the kind and amount of employee benefits it offers are reasonable given its size, financial condition, and the duties of the employees. Furthermore, an FCU's authority to offer and fund an employee benefit plan does not guarantee the permissibility or treatment of the plan under other laws, such as ERISA and the Internal Revenue Code.

Finally, § 701.19(e) provides that an FCU acting as a fiduciary, as defined in ERISA, must obtain appropriate liability coverage as provided in § 410(b) of ERISA. NCUA wishes to clarify that § 410(b) of ERISA describes certain kinds of insurance coverage and permits certain parties to purchase that insurance, but does not require any party to purchase insurance. 29 U.S.C. 1110.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed regulation may have on a substantial number of small entities (under $1 million in assets). This rule clarifies that federal credit unions have additional options and flexibility to manage their employee benefit obligations without imposing any regulatory burden. The final amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 701

Credit Unions.

By the National Credit Union Administration Board on April 24, 2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 709

Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is issuing a final rule amending its involuntary liquidation regulation to designate swap agreements (swaps) as qualified financial contracts (QFCs). Treatment of swaps as QFCs will limit swap counterparty exposure when a federally-insured credit union is placed into involuntary liquidation or a conservatorship and thereby encourage entities to engage in swaps with federally-insured credit unions. Treatment of swaps as QFCs will also help preserve market stability.

EFFECTIVE DATES: This rule is effective June 30, 2003.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Paul Peterson, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518–6555.

SUPPLEMENTARY INFORMATION:

A. Background

On February 20, 2003, NCUA issued a proposed rule that would add § 709.13 to NCUA's involuntary liquidation regulation to designate swaps as QFCs. 68 FR 8860, February 26, 2003; 12 CFR part 709.

As discussed in the preamble to the proposed rule, section 207 of the Federal Credit Union Act (FCU Act) contains provisions concerning the treatment of QFCs in liquidation or conservatorship. 12 U.S.C. 1787(c)(3), (8). Generally, these QFC provisions enable a QFC counterparty to exercise its contractual rights to terminate and net QFCs and protect itself against the selective assumption of QFCs by a liquidating agent or conservator. QFC treatment limits counterparty exposure and preserves market stability when a credit union with QFCs enters liquidation or conservatorship.

Section 207 of the FCU Act also provides that ''the term 'qualified financial contract' means any securities contract, forward contract, repurchase agreement, and any similar agreement that the [NCUA] Board determines by regulation to be a qualified financial contract for purposes of this paragraph.'' 12 U.S.C. 1787(c)(8)(D)(i). The Board has determined that swaps are similar to those agreements enumerated in the FCU Act's definition and should be recognized as QFCs. *See* H.R. Rep. No. 101–484 at 1 (recognizing that swaps are ''similar'' to forward contracts, securities contracts, and repurchase agreements), to accompany Pub. L. 101–311 (Bankruptcy: Swap Agreements and Forward Contracts), *reprinted in* 1990 U.S.C.C.A.N. 223. This Board determination that swaps receive QFC treatment will provide greater certainty about the treatment of swaps if a federally-insured credit union is placed into involuntary liquidation or a conservatorship and will encourage counterparties to engage in swaps with credit unions. This final rule also parallels the Federal Deposit Insurance Act's treatment of swaps involving banks. 12 U.S.C. 1821(e)(8)(D)(i), (vi), (vii).

As stated in the preamble to the proposed rule, the Board has determined that it will exercise its discretion as liquidating agent or conservator and provide swaps with QFC treatment if there is a liquidation or conservatorship involving swaps before this final rule is effective.

B. Comments

The Board received thirteen comment letters on the proposed rule: five from corporate credit unions, three from natural person credit unions, and five from credit union trade organizations.

All thirteen commenters expressed support for designating swaps as QFCs. Nine of the thirteen commenters recommended that the language of the proposed rule be amended to clarify that any master agreement involving swaps will be treated as a swap. The Board agrees with this recommended clarification and has added language to the final rule paralleling a similar provision in the Federal Deposit Insurance Act. 12 U.S.C. 1821(e)(8)(D)(vii).

One commenter asked that the new rule state explicitly that any conservator or liquidating agent of a credit union would be obligated to recognize all of the rights of QFC counterparties set out in section 207(c)(8)(A) of the FCU Act. 12 U.S.C. 1787(c)(8)(A). This commenter believes section 207(c)(8)(A) of the FCU Act contains an erroneous cross-reference to section 207(c)(12) of the FCU Act and that adoption of the commenter's proposed language would cure this error. 12 U.S.C. 1787(c)(12). The Board agrees that this cross-reference to section 207(c)(12) is erroneous. The correct cross-reference should be to section 207(c)(10), as indicated by comparison with parallel provisions in the Federal Deposit Insurance Act. 12 U.S.C. 1787(c)(8)(A) and 1821(e)(8)(A). Although the Board cannot issue a regulation for purposes of correcting a statute, the Board will limit its discretion when acting as a liquidating agent or conservator to allow counterparties to exercise their rights under section 207(c)(8)(A) as if that section contained a cross-reference to section 207(c)(10), not section 207(c)(12). The Board also notes the House of Representatives recently approved a bill that would, if enacted into law, correct this error. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, Title IX (Toomey Amendment).

Another commenter asked that the Board also designate commodity contracts as QFCs. The proposed rule did not address commodity contracts, and, therefore, they are beyond the scope of this final rule. Furthermore, the Board notes that natural person federal credit unions do not currently have the authority to enter into commodity contracts and that corporate credit unions may not enter into commodity contracts unless specifically authorized to engage in commodity contracts under their expanded authorities. *See* 12 CFR part 703 and 12 CFR part 704, Appendix B, Part IV.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under one million dollars in assets). The Board believes it unlikely that any small federally-insured credit unions engage in swaps. Accordingly, the Board believes that the final rule would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that this final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on

state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedures Act. 5 U.S.C. 551. NCUA has recommended to The Office of Management and Budget that it determine that this final rule is not a major rule, and is awaiting its determination.

Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose minimal regulatory burden. NCUA requested comment on whether the proposed rule met this standard. No commenters addressed the issue.

List of Subjects in 12 CFR Part 709

Credit unions, Liquidations.

By the National Credit Union Administration Board on May 22, 2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 791

Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observance of NCUA Board Meetings

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: This final rule, Interpretive Ruling and Policy Statement (IRPS) 03–2, amends the Regulatory Flexibility Act provisions of NCUA's IRPS 87–2, Developing and Reviewing Government Regulations. The Regulatory Flexibility Act generally requires federal agencies to prepare analyses to describe the impact of proposed and final rules on small entities. Since 1981, the NCUA has defined small entity in this context to mean those credit unions with less than one million dollars in assets. This final rule redefines small entity to mean those credit unions with less than ten million dollars in assets. In addition, the rule amplifies a provision regarding NCUA's policy of reviewing all existing regulations every three years by stating that one-third of existing regulations will be reviewed each year and the public will receive notice of those regulations under review. The rule also updates IRPS 87–2 with a reference to the U.S. Small Business Administration guidance on implementation of the Regulatory Flexibility Act and to a Small Business Regulatory Enforcement Fairness Act requirement for publication of the factual basis supporting any certification that a particular rule will not have a significant economic impact on a substantial number of small entities.

DATES: This rule is effective June 30, 2003.

FOR FURTHER INFORMATION CONTACT: Paul M. Peterson, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6555.

SUPPLEMENTARY INFORMATION:

A. Background

In 1981, the NCUA defined small credit union for purposes of the Regulatory Flexibility Act (RFA), Pub. L. 96–354, as any credit union having less than one million dollars in assets. NCUA IRPS 81–4, 46 FR 29248, June 1, 1981. IRPS 87–2 superseded IRPS 81–4 but continued the definition of small credit unions for purposes of the RFA as those with less than one million dollars in assets. 52 FR 35231, 35232, September 8, 1987. IRPS 87–2 is incorporated by reference into NCUA's current rule governing the promulgation of regulations. 12 CFR 791.8(a).

The Board believes that NCUA's current definition of small credit union as one with less than one million dollars in assets, adopted in 1981, is now outdated. On November 21, 2002, the Board issued a Notice of Proposed Rulemaking (NPRM) to amend the definition of small credit union in IRPS 87–2. 67 FR 72113, December 4, 2002. The Board proposed to change the qualifying asset size for a small credit union from less than one million dollars in assets to less than ten million dollars in assets. This final rule adopts the proposed rule's definition of small credit union.

As discussed in the NPRM, the RFA is intended in part to encourage federal agencies to give special attention when making rules to the inability of smaller entities to handle incremental compliance burdens created by new rules. Credit unions with ten or more million dollars in assets have staff that may devote some of their time to compliance issues and incremental compliance burdens, but credit unions with significantly less than ten million dollars in assets may be forced to seek and pay for outside assistance when addressing incremental compliance burdens. Accordingly, credit unions with more than ten million dollars in assets should be able to handle incremental compliance burdens more easily than credit unions with less than ten million dollars in assets.

A definition of small credit union as one with less than ten million dollars in assets is also consistent with recent statutes and NCUA regulations providing credit unions with regulatory compliance relief. For example, in 1998 Congress amended the Federal Credit Union Act to require that credit unions follow generally accepted accounting principles, but at the same time excused credit unions with less than ten million dollars in assets under a *de minimus* exception. 12 U.S.C. 1782(a)(6)(C)(i), (iii). Another 1998 amendment to the FCUA requires NCUA to provide ''small credit unions,'' defined as those under ten million dollars in assets, with special assistance in meeting prompt corrective action requirements. 12 U.S.C. 1790d(f)(2). Finally, NCUA regulations provide that federally insured credit unions with less than ten million dollars in assets may file a short form call report in the spring and fall. 12 CFR 741.6(a).

The Board also notes that by increasing the threshold from one million dollars in assets to ten million dollars in assets the percentage of federally insured credit unions considered to be small will return to a percentage much closer to the percentage captured by the size standard first adopted in 1981.

The Board also proposed to add a provision in Section IV of IRPS 87–2 stating how NCUA carries out the policy of reviewing all existing regulations every three years and providing for notice to the public of that portion of the regulations that are under review each year. The final rule includes this provision.

This final rule includes a reference to *The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies* (U.S. Small Business Administration, November, 2002) and requires NCUA staff to consult it when interpreting and implementing the requirements of the RFA. While a regulatory flexibility analysis is unnecessary if the Board certifies a regulation will not have a significant economic effect on a substantial number of small entities, the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) requires that agencies publish a statement ''providing the factual basis for'' any such certification in the **Federal Register**. Pub. L. 104–121, 5 U.S.C. 605(b). IRPS 87–2 has provided that the certification will be published with a statement ''explaining'' the certification. This final rule replaces ''explaining'' with ''providing the factual basis for.''

B. Summary of Comments

NCUA received seventeen comment letters on the proposed rule: two from federal credit unions, five from state credit unions, eight from credit union trade organizations, one from a bank trade organization, and one from the National Association of State Credit Union Supervisors.

All of the commenters expressed support for changing the definition of small credit union to include more credit unions in the definition, with most of the commenters agreeing that small credit union should be redefined as a credit union with less than ten million dollars in assets. In addition, all the commenters who addressed the proposal to provide public notice of those regulations NCUA is reviewing each year as part of its three-year rolling review expressed approval for that notice.

Comments on the Asset Size Threshold for Small Credit Unions

The eleven commenters who supported a ten million dollar threshold

generally noted it was consistent with current statutory definitions of small credit union and with the effects of inflationary changes since 1981 and would result in a reasonable percentage of all credit unions (about 52%) being considered small. One commenter supported the ten million dollar threshold but stated it should not be greater than ten million.

Five commenters thought the asset threshold should be greater than ten million dollars. Of these commenters, two thought the threshold should be 20 million dollars, one thought it should be 25 million dollars, one thought it should be at least 50 million dollars, and another thought it should be 100 million dollars.

The commenters supporting thresholds of 20 and 25 million dollars note that the percentage of credit unions under one million dollars in assets in 1981, when the current definition of small credit union was established, was roughly 63% of all credit unions, and that the percentages of credit unions today under 20 million and 25 million dollars (66% and 70%, respectively) are close to 63%. One of these commenters also states that ''credit unions with 20 million dollars in assets, although slightly larger than those with ten million dollars in assets, typically still do not have the resources to devote staff time solely to compliance issues.''

The commenter who supported a 50 million dollar threshold stated that: (1) only 10% of credit unions under 20 million dollars in assets have ''paid compliance directors,'' (2) only 16% of credit unions under 50 million dollars in assets have such directors, and (3) only 31% of credit unions between 50 million and 100 million dollars in assets have such directors. This commenter also noted that the federal banking regulators and the U.S. Small Business Administration generally set the RFA's small entity threshold for their regulated financial entities at 150 million dollars in assets. The commenter who supported a 100 million dollar threshold also made similar comments.

The Board appreciates the comments of those who supported a more expansive definition of small credit union but notes that a majority of the commenters supported the proposed definition. Further, the proposed is consistent with other statutory uses of the term small credit union while more expansive definitions would not be. In addition, while credit unions with ten million dollars or more in assets may not have staff devoted exclusively to compliance issues, the Board concludes, as noted in the NPRM, they are likely to have some staff that can devote time to compliance. This analysis is appropriate in light of the legislative history of the RFA discussed in the NPRM. Accordingly, the Board has decided to adopt the definition of small credit union from the proposed rule.

Miscellaneous Comments on the Definition of Small Credit Union and Applicability of the RFA

A few commenters thought the asset threshold for small credit unions should be adjusted periodically: one suggested revisiting the threshold each year; two suggested tying it to inflation; and another suggested that NCUA should reset the threshold yearly by declaring as small that group of the smallest credit unions whose combined assets equal 10% of the aggregate assets of all credit unions. The Board believes that annual adjustment is unnecessary and might have undesirable consequences. For example, with inflation levels likely to remain low for the foreseeable future, the Board does not think the threshold needs to be revisited each year. In addition, the rulemaking process for particular rules often spans more than one calendar year, and it would be difficult and confusing to change the definition for rules in progress every year. Finally, the use of a fixed, round number makes it easier to assess which credit unions are small and to explain how NCUA is applying the RFA analysis in a particular rulemaking. The Board will revisit the definition of small credit union as necessary in the future.

One commenter thought that, for rules in which the NCUA determines the RFA does not apply, the NCUA should publish details of its determination. As discussed above, this final rule amends IRPS 87–2 to reflect the SBREFA requirement that NCUA publish the factual basis for each certification in the **Federal Register**.

Two commenters thought the NCUA should go beyond the requirements of the RFA and should undertake and publish a detailed analysis of the economic impact of each rule on all credit unions, regardless of asset size. The Board does not believe an RFA-type analysis is needed for every rulemaking, but notes that it is NCUA's longstanding policy, as stated in IRPS 87–2, that it will impose only minimum required burdens on credit unions.

Miscellaneous Comments About Public Notice of Regulations Under NCUA Review

One commenter suggested that each year at its December meeting the Board announce which regulations would be reviewed by the NCUA Office of General Counsel in the coming year and which provisions in those regulations were specifically under consideration for change. The commenter thought this notice should be published both on the agency's website and in the **Federal Register**. Another commenter wanted the notice of regulations under review published twice a year and a designated contact point at NCUA for all questions and comments about a regulation under review.

The Board will publish notice of the regulations under rolling review in a particular year far enough in advance of the review to give interested parties a meaningful opportunity for input. The notice may be published on NCUA's website, in the **Federal Register**, or in other appropriate media as determined by NCUA. NCUA also publishes a semi-annual regulatory agenda in the **Federal Register** as part of the federal government's Unified Agenda of Federal Regulatory and Deregulatory Actions. That agenda, generally published each November and May, includes contact information and a description of rules that are in process or on which regulatory action is anticipated for the next 12 months.

One commenter thought that NCUA should add the following statement to IRPS 87–2: ''Nothing in the Office of General Counsel's rolling review schedule prohibits the review of existing regulations ahead of schedule.'' While the Board believes that this is a true statement, the Board does not believe it need be added to IRPS 87–2.

Other Miscellaneous Comments

Two commenters thought the definition of small credit union in the Small Credit Union Program (SCUP) should be changed to correlate with the RFA definition. Another commenter stated the NCUA should also provide a definition of large credit unions. Since this rule applies only to NCUA rulemaking and the requirements of the RFA and does not affect the SCUP or large credit unions, these two issues are not addressed in the final rule.

Regulatory Procedures

Regulatory Flexibility Act

The RFA requires the NCUA to prepare an analysis to describe any significant economic effect any regulation may have on a substantial number of small credit unions, currently meaning those under one million dollars in assets. This final rule, when effective, will change the definition of small credit union to increase the number of credit unions receiving the procedural benefits of the RFA and will provide notice to the public and

opportunity to comment on regulations under internal review. This final rule is procedural in nature and will not have any ascertainable economic impact on credit unions. Accordingly, the NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. No regulatory flexibility analysis is required.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

Paperwork Reduction Act

NCUA has determined that the final rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The SBREFA provides for congressional review of agency rules. A reporting requirement is generally triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. Rules relating to management, personnel, or agency procedure or practice that do not substantially affect the rights or obligations of non-agency parties are exempt from congressional review. 5 U.S.C. 804(3). The NCUA Board has determined that this final rule, which deals with agency procedures and does not substantially affect the rights or obligations of non-agency parties, is exempt from congressional review.

List of Subjects in 12 CFR Part 790

Organization and functions (government agencies).

By the National Credit Union Administration Board on May 22, 2003.

Becky Baker,

Secretary of the Board.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 21

[Docket No. 03–08]

RIN 1557–AC06

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 211

[Docket No. R–1127]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 326

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 563

[Docket No. 2003–16]

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 748

RIN 3133

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506–AA31

Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks

AGENCIES: The Financial Crimes Enforcement Network, Treasury; Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; National Credit Union Administration.

ACTION: Joint final rule.

SUMMARY: The Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), together with the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (collectively, the Agencies), have jointly adopted a final rule to implement section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required To Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act). Section 326 requires the Secretary of the Treasury (Secretary) to jointly prescribe with each of the Agencies, the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC), a regulation that, at a minimum, requires financial institutions to implement reasonable procedures to verify the identity of any person seeking to open an account, to the extent reasonable and practicable; maintain records of the information used to verify the person's identity; and determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. This final regulation applies to banks, savings associations, credit unions, private banks, and trust companies.

DATES: *Effective Date:* This rule is effective June 9, 2003.

Compliance Date: Each bank must comply with this final rule by October 1, 2003.

FOR FURTHER INFORMATION CONTACT:

OCC: Office of the Chief Counsel at (202) 874–3295.

Board: Enforcement and Special Investigations Sections at (202) 452–5235, (202) 728–5829, or (202) 452–2961.

FDIC: Special Activities Section, Division of Supervision and Consumer Protection, and Legal Division at (202) 898–3671.

OTS: Compliance Policy Division at (202) 906–6012.

NCUA: Office of General Counsel at (703) 518–6540; or Office of Examination and Insurance at (703) 518–6360.

Treasury: Office of the Chief Counsel (FinCEN) at (703) 905–3590; Office of the General Counsel (Treasury) at (202) 622–1927; or the Office of the Assistant General Counsel for Banking & Finance (Treasury) at (202) 622–0480.

SUPPLEMENTARY INFORMATION:

I. Background

A. Section 326 of the USA PATRIOT Act

On October 26, 2001, President Bush signed into law the USA PATRIOT Act, Pub. L. 107–56. Title III of the Act, captioned ''International Money Laundering Abatement and Anti-terrorist Financing Act of 2001,'' adds several new provisions to the Bank Secrecy Act (BSA), 31 U.S.C. 5311 *et seq.* These provisions are intended to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism.

Section 326 of the Act adds a new subsection (l) to 31 U.S.C. 5318 of the BSA that requires the Secretary to prescribe regulations ''setting forth the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution.''

Section 326 applies to all ''financial institutions.'' This term is defined very broadly in the BSA to encompass a variety of entities, including commercial banks, agencies and branches of foreign banks in the United States, thrifts, credit unions, private banks, trust companies, investment companies, brokers and dealers in securities, futures commission merchants, insurance companies, travel agents, pawnbrokers, dealers in precious metals, check-cashers, casinos, and telegraph companies, among many others. *See* 31 U.S.C. 5312(a)(2) and (c)(1)(A).

For any financial institution engaged in financial activities described in section 4(k) of the Bank Holding Company Act of 1956 (section 4(k) institutions), the Secretary is required to prescribe the regulations issued under section 326 jointly with each of the Agencies, the SEC, and the CFTC (the Federal functional regulators).

Section 326 of the Act provides that the regulations must require, at a minimum, financial institutions to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. In prescribing these regulations, the Secretary is directed to take into consideration the various types of accounts maintained by various types of financial institutions, the various methods of opening accounts, and the various types of identifying information available.

B. Overview of Comments Received

On July 23, 2002, Treasury and the Agencies published a joint notice of proposed rulemaking in the **Federal Register** (67 FR 48290) applicable to (a) any financial institution defined as a ''bank'' in 31 CFR 103.11(c) [1] and subject

[1] This definition includes banks, savings associations, credit unions, Edge Act and Agreement corporations, and branches and agencies of foreign banks.

to regulation by one of the Agencies; and (b) any foreign branch of an insured bank. On the same date, Treasury separately published an identical, proposed rule for credit unions, private banks, and trust companies that do not have a Federal functional regulator (67 FR 48299).[2] Treasury and the Agencies proposed general standards that would require each bank to design and implement a customer identification program (CIP) tailored to the bank's size, location, and type of business. The proposed rule also included certain specific standards that would be mandated for all banks.[3]

Treasury and the Agencies collectively received approximately five hundred comments in response to these proposed rules (collectively referred to as the ''proposal'' or the ''proposed rule'' for ''banks''), although some commenters sent copies of the same letter to Treasury and to each of the Agencies. The majority of comments received by Treasury and the Agencies were from banks, savings associations, credit unions, and their trade associations. Most of these commenters agreed with the largely risk-based approach set forth in the proposal that allowed each bank to develop a CIP based on its specific operations.

Some commenters, however, criticized the specific requirements in the proposed rule and suggested that Treasury and the Agencies issue a final rule containing an entirely risk-based approach without any minimum identification and verification requirements. According to some of these commenters, such a thoroughly risk-based approach would give banks appropriate discretion to focus their efforts and finite resources on specific, high-risk accounts most likely to be used by money-launderers and terrorists.

Other commenters, especially those representing credit card banks and credit card issuers, asserted that the proposed minimum identification and verification requirements should be eliminated because they did not take into account the unique nature of credit card operations. They warned that these requirements, if implemented, would have a chilling effect on credit practices important to U.S. consumers and would impose significant compliance costs on their industry with little benefit to law enforcement.

By contrast, some smaller banks criticized the flexibility of the proposal and stated that a risk-based approach would leave too much room for interpretation by the Agencies. These commenters urged Treasury and the Agencies to issue a final rule establishing more specific requirements. For example, some commenters suggested that the rule prescribe risk assessment levels for each customer type and type of account, along with a specific description of acceptable forms of identification and methods of verification appropriate for each bank's size and location.

While commenters representing various segments of the industry differed on the approach that should be taken in the final rule, the vast majority concluded that Treasury and the Agencies had underestimated the compliance burden that would be imposed by certain elements of the proposal. Commenters were especially concerned about the proposed requirements that banks verify the identity of signatories on accounts, keep copies of documents used to verify a customer's identity, and retain identity verification records for five years after an account is closed.

Some commenters also suggested that banks be given greater flexibility when dealing with established customers and urged that banks be permitted to rely on identification and verification of customers performed by a third party, including an affiliate. Other commenters asked for additional guidance regarding the lists of known and suspected terrorists and terrorist organizations that must be checked, and regarding what will be deemed adequate notice to customers for purposes of complying with the final rule. Many commenters requested that the final rule contain a delayed implementation date that would provide banks with the time needed to design a customer identification program, obtain board approval, alter existing policies and procedures, forms and software, and train staff.

Several comments were received from companies engaged in the sale of technology or services that could be used to identify and verify customers, retain records, and check lists of known and suspected terrorists and terrorist organizations. Many of these companies recommended that the proposed rule be modified to make clear that use of specific products and services would be permissible. Some of these commenters urged that the rule require banks to authenticate any documents obtained to verify the identity of the customer through the use of automated document authentication technology.

A small number of comments were received from individuals. Some of these individuals criticized the proposed requirement that banks obtain a social security number from persons opening an account as an infringement upon individual liberty and privacy. Some individuals were concerned that this requirement would expose them to an added risk of identity theft. Other individuals supported the proposal and concluded that its verification requirements might diminish instances of identity theft and fraud. A few commenters suggested that the government develop a separate national identification number or require that social security cards bear photographs and or other safeguards.

A variety of commenters applauded the efforts of Treasury and the Federal functional regulators to devise a uniform set of rules that apply to banks, broker-dealers, mutual funds, futures commission merchants, and introducing brokers.[4] They noted that, without uniformity, customers of financial institutions may seek to open accounts with institutions that customers perceive to have less robust customer identification requirements. These commenters also suggested revisions that would enhance the uniformity of the rules.

Treasury and the Agencies have modified the proposed rule in light of the comments received. A discussion of the comments, and the manner in which the proposed rule has been modified, follows in the section-by-section analysis.

In addition, as suggested by a number of commenters, Treasury and the Agencies expect to issue supplementary guidance following issuance of the final rule.

C. Joint Issuance by Treasury and the Agencies

The final rule implementing section 326 is being issued jointly by Treasury, through FinCEN, and by the Agencies. It applies to (1) a ''bank,'' as defined in 31 CFR 103.11(c), that is subject to regulation by one of the Agencies, and (2) to any non-Federally insured credit union, private bank or trust company that does not have a Federal functional regulator (collectively referred to in the final rule as ''a bank'').

[2] In the preamble for this proposed rule, Treasury explained that a single final regulation would be issued for all financial institutions defined as ''banks'' under 31 CFR 103.11(c), with modifications to accommodate certain differences between Federally regulated and non-Federally regulated banks. *See* 67 FR 48299, 48300.

[3] At the same time, Treasury also published (1) together with the SEC, proposed rules for broker-dealers (67 FR 48306) and mutual funds (67 FR 48318); and (2) together with the CFTC, proposed rules for futures commission merchants and introducing brokers (67 FR 48328).

[4] *See* footnote 3, *supra.*

The substantive requirements of this joint final rule are being codified as part of Treasury's BSA regulations located in 31 CFR part 103. In addition, each of the Agencies is concurrently publishing a provision in its own regulations [5] to cross-reference this final rule in order to clarify the applicability of the final rule to the banks subject to its jurisdiction.

Regulations governing the applicability of section 326 to certain financial institutions that are regulated by the SEC and the CFTC are the subject of separate rulemakings. Treasury, the Agencies, the SEC, and the CFTC consulted extensively in the development of all joint rules implementing section 326 of the Act. All of the participating agencies intend the effect of the rules to be uniform throughout the financial services industry. Treasury intends to issue separate rules under section 326 for certain non-bank financial institutions that are not regulated by one of the Federal functional regulators.

The Secretary has determined that the records required to be kept by section 326 of the Act have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, to protect against international terrorism.

In addition, Treasury, under its own authority, is issuing conforming amendments to 31 CFR 103.34, which imposes requirements concerning the identification of bank customers.

D. Compliance Date

Nearly all commenters on the proposed rule requested that banks be given adequate time to develop and implement the requirements of any final rule implementing section 326 of the Act. These commenters stated that if the proposed rule were implemented, banks would be required, among other things, to revise existing account opening policies and procedures, obtain board approval, train staff, update forms, purchase new or updated software for customer verification and checking of government lists, and purchase new equipment for copying or scanning and storing records. Commenters requested a delayed effective or compliance date, but, given the variety of banks that would be covered by the final rule, there was no consensus regarding the amount of time that would be necessary to comply with the final rule. The transition periods suggested by commenters ranged from 60 days to two years from the date a final rule is published.

The final rule modifies various aspects of the proposal and eliminates some of the requirements that commenters identified as being most burdensome. Nonetheless, Treasury and the Agencies recognize that some banks will need time to develop a CIP, obtain board approval, and implement the CIP, which will include various measures, such as training of staff, reprinting forms, and developing new software. Accordingly, although this final rule will be effective 30 days after publication, banks are provided with a transition period to implement the rule. Treasury and the Agencies have determined that each bank must fully implement its CIP by October 1, 2003.

II. Section-by-Section Analysis of Final Rule Implementing Section 326

Section 103.121(a) Definitions

Section 103.121(a)(1) Account. The proposed rule defined ''account'' as each formal banking or business relationship established to provide ongoing services, dealings, or other financial transactions and stated that a deposit account, transaction or asset account, and a credit account or other extension of credit would each constitute an ''account.'' [6] The proposal also explained that the term ''account'' was limited to formal banking and business relationships established to provide ''ongoing'' services, dealings, or other financial transactions to make clear that this term is not intended to cover infrequent transactions such as the occasional purchase of a money order or a wire transfer.

Treasury and the Agencies received a large number of comments on this proposed definition. Some commenters agreed with the proposed definition though others thought the definition of ''account'' was either too broad or needed clarification. Some commenters suggested that the definition of ''account'' be narrowed to include only those relationships that are financial in nature. A number of commenters urged that the definition be limited to high-risk relationships that experts have identified as actually used by money launderers and terrorists. Some of these commenters suggested that particular types of accounts, especially those established as part of employee benefit plans, be excluded from the definition of ''account.''

Most commenters requested that the final rule provide additional examples of the relationships that would constitute an ''account.'' Many commenters requested that the rule clarify the meaning of ''ongoing services.'' These commenters asked whether a person who repeatedly and regularly purchased a money order, requested a wire transfer, or cashed a check on a weekly basis, without any other relationship with a bank, would be considered to have an ''account.'' Many other commenters asked that the exclusion for transfers of accounts between banks described in the preamble for the proposal—which commenters characterized as the ''transfer exception'' —be stated expressly in the regulation and expanded to cover all loans originated by a third party and purchased by a bank, such as mortgages purchased from non-bank lenders and vehicle loans purchased from car dealers.

The final rule contains a number of changes prompted by these comments. First, the reference to the term ''business relationship'' has been deleted from the definition of ''account.'' This change is made to clarify that the regulation applies to the bank's provision of financial products and services, as opposed to general ''business'' dealings, such as those in connection with the bank's own operations or premises. Second, the definition now contains additional, but non-exclusive, examples of products and services, such as safety deposit box and other safekeeping services, cash management, and custodian and trust services, that constitute an ''account.''

The definition of ''account'' also has been changed to include a list of products and services that will not be deemed an ''account.'' The preamble for the proposed rule had used the term ''ongoing services'' to define accounts covered by the final rule, and had referred to the exclusion of ''occasional'' transactions and ''infrequent'' purchases (which arguably would require a bank to monitor all transactions for repetitive contacts). By contrast, the final rule clarifies that ''account'' excludes products and services where a *formal banking relationship* is not established with a person, such as check cashing, wire transfer, or the sale of a check or money order.[7] Treasury and the

[5] 12 CFR 21.21 (OCC); 12 CFR 208.63, 211.5, and 211.24 (FRB); 12 CFR 326.8 (FDIC); 12 CFR 563.177 (OTS); and 12 CFR 748.2 (NCUA).

[6] The definition of ''account'' in the proposed rule was based on the statutory definition of ''account'' that is used in section 311 of the Act.

[7] This exclusion is consistent with legislative history indicating that by referencing the term ''customers,'' Congress intended ''that the regulations prescribed by Treasury take an approach similar to that of regulations promulgated under title V of the Gramm-Leach-Bliley Act of 1999, where the Federal functional regulators defined ''customers'' and ''customer relationship'' for purposes of the financial privacy rules.'' H.R. Rep. No. 107–250, pt. 1, at 62 (2001). The definitions of ''customer'' and ''customer

Agencies note that part 103 already requires verification of identity in connection with many of these products and services. *See, e.g.,* 31 CFR 103.29 (purchases of bank checks and drafts, cashier's checks, money orders, and traveler's checks for $3000 or more); 31 CFR 103.33 (funds transfers of $3000 or more).

In addition, the final rule codifies and clarifies the ''transfer exception.'' Under the final rule, the definition of ''account'' excludes accounts that a bank acquires through an acquisition, merger, purchase of assets, or assumption of liabilities from any third party.[8] Treasury and the Agencies note that the Act provides that the regulations shall require reasonable procedures for ''verifying the identity of *any person seeking to open an account.*'' Because these transfers are not initiated by customers, these accounts do not fall within the scope of section 326.[9]

Treasury and the Agencies generally agree with the view expressed by commenters who suggested that a bank's limited resources be focused on relationships that pose a higher risk of money laundering and terrorism. Accordingly, the Agencies have included an exception to the definition of ''account'' for accounts opened for the purpose of participating in an employee benefit plan established pursuant to the Employee Retirement Income Security Act of 1974. These accounts are less susceptible to use for the financing of terrorism and money laundering, because, among other reasons, they are funded through payroll deductions in connection with employment plans that must comply with Federal regulations which impose various requirements regarding the funding and withdrawal of funds from such accounts, including low contribution limits and strict distribution requirements.

Section 103.121(a)(2) Bank. The proposal jointly issued by Treasury and the Agencies applied to any financial institution defined as a ''bank'' in 31 CFR 103.11(c) and subject to regulation by one of the Agencies, including banks, savings associations, credit unions, Edge Act and Agreement corporations, and branches and agencies of foreign banks. The proposed definition also included ''any foreign branch of an insured bank'' to make clear that the procedures required by the rule would have to be implemented throughout the bank, no matter where its offices are located. The preamble for the proposal explained that the rule would apply to bank subsidiaries to the same extent as existing regulations requiring banks to have BSA compliance programs.[10] As described above, a second proposal issued simultaneously by Treasury applied to certain other financial institutions defined as a ''bank'' in 31 CFR 103.11(c), namely, those credit unions, private banks, and trust companies that do not have a Federal functional regulator.

Under the final rule, ''bank'' includes all financial institutions covered by both of the proposals described above, except that ''bank'' does not include any foreign branch of an insured U.S. bank. Several commenters explained that the proposal to cover foreign branches might conflict with local laws applicable to branches of insured banks operating outside of the United States and might place U.S. institutions at a competitive disadvantage. Consistent with the approach taken with respect to final regulations implementing other sections of the Act,[11] Treasury and the Agencies have determined that foreign branches of insured U.S. banks are not covered by the final rule. Nevertheless, Treasury and the Agencies encourage each bank to implement an effective CIP, as required by this final rule, throughout its organization, including in its foreign branches, except to the extent that the requirements of the rule would conflict with local law.

As noted in the preamble for the proposal, the CIP must be a part of a bank's BSA compliance program. Therefore, it will apply throughout such a bank's U.S. operations (including subsidiaries) in the same way as the BSA compliance program requirement. However, all subsidiaries that are in compliance with a separately applicable, industry-specific rule implementing section 326 of the Act will be deemed to be in compliance with this final rule.

Section 103.121(a)(3) Customer. The proposal defined ''customer'' to mean any person [12] seeking to open a new account. In addition, the proposal defined a ''customer'' to include any signatory on an account. The preamble for the proposal explained that the term ''customer'' included a person that applied to open an account, but not someone seeking information about an account, such as rates charged or interest paid on an account, if the person did not apply to open an account. The preamble also stated that any person seeking to open an account at a bank, on or after the effective date of the final rule, would be a ''customer,'' regardless of whether that person already had an account at the bank.

This proposed definition prompted a large number of comments. First, nearly all commenters recommended that the Agencies clarify in the text of the final rule that ''customer'' does not include a person who does not receive banking services, such as a person whose deposit or loan application is denied. Some of these commenters suggested that the rule for banks define ''customer'' to mean ''a person who opens a new account,'' as did the proposed rules for broker-dealers, mutual funds, futures commission merchants and introducing brokers.

relationship'' in the financial privacy rules apply only to a consumer who has a ''continuing relationship'' with a bank, for example, in the form of a deposit or investment account, or a loan. *See* .3(h) and (i) of 12 CFR part 40 (OCC); 12 CFR part 216 (Board); 12 CFR part 332 (FDIC); 12 CFR part 573 (OTS); and 12 CFR part 716 (NCUA).

[8] In many cases, these third parties are themselves ''financial institutions'' for purposes of the BSA. Treasury anticipates that these third parties ultimately will be subject to their own customer identification rules implementing section 326 of the Act in the event that they are not presently covered by such a rule.

[9] Nevertheless, there may be situations involving the transfer of accounts where it would be appropriate for a bank, as part of the customer due diligence procedures required under existing regulations requiring banks to have compliance programs implementing the BSA (BSA compliance programs), to verify the identity of customers associated with accounts that it acquires from another financial institution. Treasury and the Agencies expect financial institutions to implement reasonable procedures to detect money laundering in any account, however acquired.

[10] All insured depository institutions currently must have a BSA compliance program. *See* 12 CFR 21.21 (OCC); 12 CFR 208.63 (Board); 12 CFR 326.8 (FDIC); 12 CFR 563.177 (OTS); and 12 CFR 748.2 (NCUA). In addition, all financial institutions are required by section 352 of the Act, 31 U.S.C. 5318(h), to develop and implement an anti-money laundering program. Treasury issued a regulation implementing section 352 providing that a financial institution regulated by a Federal functional regulator is deemed to satisfy the requirements of section 5318(h)(1) if it implements and maintains an anti-money laundering program that complies with the regulation of its Federal functional regulator, *i.e.,* the requirement to implement a BSA compliance program. *See* 31 CFR 103.120(b); 67 FR 2113 (April 29, 2002). However, Treasury temporarily deferred subjecting certain non-Federally regulated banks to the anti-money laundering program requirements in section 352. *See* 67 FR 67547 (November 6, 2002) (corrected 67 FR 68935 (November 14, 2002)).

[11] *See, e.g.,* 67 FR 60562, 60565 (Sept. 26, 2002) (FinCEN's regulation titled ''Anti-Money Laundering Requirements ''Correspondent Accounts for Foreign Shell Banks: Recordkeeping and Termination of Correspondent Accounts for Foreign Banks' implementing sections 313 and 319(b) of the Act).

[12] The proposed rule defined ''person'' by reference to § 103.11(z). This definition includes individuals, corporations, partnerships, trusts, estates, joint stock companies, associations, syndicates, joint ventures, other unincorporated organizations or groups, certain Indian Tribes, and all entities cognizable as legal personalities. Treasury and the Agencies agree that it is not necessary to repeat this definition. Therefore, it is omitted from the final rule.

Treasury and the Agencies agree with the view expressed by some commenters that the statute should be construed to ensure that banks design procedures to determine the identity of only those persons who open accounts. Accordingly, the final rule defines a ''customer'' as ''a person that opens a new account.'' [13] For example, in the case of a trust account, the ''customer'' would be the trust. For purposes of this rule, a bank will not be required to look through trust, escrow, or similar accounts to verify the identities of beneficiaries and instead will only be required to verify the identity of the named accountholder.[14] In the case of brokered deposits, the ''customer'' will be the broker that opens the deposit account. A bank will not need to look through the deposit broker's account to determine the identity of each individual sub-account holder; it need only verify the identity of the named accountholder.

Many commenters requested that the final rule clarify whether ''customer'' includes a minor child or an informal group with a common interest, such as a club account, where there is no legal entity. The final rule addresses these comments by providing that ''customer'' means ''an individual who opens a new account for (1) an individual who lacks legal capacity, such as a minor; or (2) an entity that is not a legal person, such as a civic club.''

A few banks stated that defining ''customer'' to include a signatory was consistent with their current practice of verifying the identity of the named accountholder and any signatory on the account. However, most commenters strenuously objected to the inclusion of a signatory as a customer whose identity must be verified, and asserted that this proposed requirement would deviate significantly from their current business practices. These commenters stated that requiring banks to verify signatories on an account would be enormously burdensome to the financial institutions and signatories themselves—many of whom simply work as employees for firms with corporate accounts—and would outweigh any benefit.[15] One commenter asserted that inclusion of signatories as customers went beyond the scope of section 326 of the Act. Although some commenters advocated that any requirement regarding a signatory should be omitted altogether, these commenters generally advocated a risk-based approach that would give banks the discretion to determine when a signatory's identity should be verified.

Credit card banks, in particular, were critical of the signatory requirement because the proposed provision, as drafted, encompassed all authorized users of credit cards. These banks characterized the signatory requirement as unnecessary in the case of credit card companies, which, they explained, already use sophisticated fraud filters to detect fraud and abnormal use. These banks also noted that a person need not be a signatory to use another person's credit card, especially when purchasing products by telephone or over the Internet. Therefore, the signatory requirement would not necessarily ensure that banks would be able to verify the identity of those using a credit card account.

After revisiting the issue of whether a signatory should be a ''customer,'' Treasury and the Agencies have determined that requiring a bank to expend its limited resources on verifying the identity of all signatories on accounts could interfere with the bank's ability to focus on identifying customers and accounts that present a higher risk of not being properly identified. Accordingly, the proposed provision defining ''customer'' to include a signatory on an account is deleted. Instead, the final rule, at § 103.121(b)(2)(ii)(C), requires a bank's CIP to address situations when the bank will take additional steps to verify the identity of a customer that is not an individual by seeking information about individuals with authority or control over the account, including signatories, in order to verify the customer's identity.

In addition to defining who is a ''customer,'' the final rule contains a list of entities that will not be deemed ''customers.'' Many commenters questioned why a bank should be required to verify the identity of a government agency or instrumentality opening a new account, or of a publicly-traded company that is subject to SEC reporting requirements. Consistent with these and other comments urging that the final rule focus on requiring verification of the identity of customers that present a higher risk of not being properly identified, the final rule excludes from the definition of ''customer'' the following readily identifiable entities: a financial institution regulated by a Federal functional regulator; a bank regulated by a state bank regulator; and governmental agencies and instrumentalities, and companies that are publicly traded described in § 103.22(d)(2)(ii)–(iv).[16] Section 103.22(d)(2)(iv) exempts such companies only to the extent of their domestic operations. Accordingly, a bank's CIP will apply to any foreign offices, affiliates, or subsidiaries of such entities that open new accounts.

A great many commenters also objected to the requirement in § 103.121(b)(2)(ii) of the proposed rule that a bank verify the identity of an existing customer seeking to open a new account unless the bank previously verified the customer's identity in accordance with procedures consistent with the proposed rule and continues to have a reasonable belief that it knows the true identity of the customer. These commenters asserted that such a requirement would be burdensome for the bank and would upset existing customers. Some commenters recommended that the rule apply prospectively to new customers who previously had no account with the bank. Many commenters suggested that the final rule contain a risk-based approach where verification would not be required for an existing customer who opens a new account if the bank has a reasonable belief that it knows the identity of the customer, regardless of the procedures the bank followed to form this belief.

[13] Therefore, each person named on a joint account is a ''customer'' under this final rule unless otherwise provided.

[14] However, based on a bank's risk assessment of a new account opened by a customer that is not an individual, a bank may need to take additional steps to verify the identity of the customer by seeking information about individuals with ownership or control over the account in order to identify the customer, as described in § 103.121(b)(2)(ii)(C), or may need to look through the account in connection with the customer due diligence procedures required under other provisions of its BSA compliance program.

[15] Commenters contended that banks and individuals would confront numerous practical problems. Some commenters noted, for example, that the identification and verification of signatories could be burdensome for banks because business accounts might have many signatories and those signatories would change over time. Some commenters explained that collecting detailed information about an employee who is a signatory would raise privacy concerns for those employees who would be required to disclose personal information to their employer's financial institutions. Other commenters stated that a signatory rarely is present at the time of account opening and, consequently, a bank would encounter substantial obstacles when attempting to verify the signatory's identity using any of the most common methods described in the proposal, including by examining documents or by obtaining a credit report. (Under the Fair Credit Reporting Act (FCRA), a consumer reporting agency generally may furnish a consumer report in connection with transactions involving the consumer and no other. *See* 15 U.S.C. 1681b. Thus, for example, a bank would be prohibited from obtaining a credit report to verify the identity of an authorized user of a customer's credit card.)

[16] Treasury previously determined that banks should be exempted from having to file reports of transactions in currency in connection with these entities. *See* 31 CFR 103.22(d)(1).

Treasury and the Agencies acknowledge that the proposed rule might have had unintended consequences for bank-customer relationships and that the risk-based approach suggested by commenters would avoid these consequences. Accordingly, the final rule excludes from the definition of ''customer'' a person that has an existing account with the bank, provided that the bank has a reasonable belief that it knows the true identity of the person.[17]

Section 103.121(a)(4) Federal functional regulator. The proposed rule defined ''Federal functional regulator'' by reference to § 103.120(a)(2), meaning each of the Agencies, the SEC, and the CFTC. There were no comments on this definition, and Treasury and the Agencies have adopted it as proposed.

Section 103.121(a)(5) Financial institution. The final rule includes a new definition for the term ''financial institution'' that cross-references the BSA, 31 U.S.C. 5312(a)(2) and (c)(1). This is a more expansive definition of ''financial institution'' than that in 31 CFR 103.11, and includes entities such as futures commission merchants and introducing brokers.

Section 103.121(a)(6) Taxpayer identification number. The proposed rule repeated the language from § 103.34(a)(4), which states that the provisions of section 6109 of the Internal Revenue Code and the regulations of the Internal Revenue Service thereunder determine what constitutes ''a taxpayer identification number.'' There were no comments on this approach, and Treasury and the Agencies have adopted it substantially as proposed, with minor technical modifications.

Section 103.121(a)(7) and (8) U.S. Person and non-U.S. person. The proposed rule provided that ''U.S. person'' is an individual who is a U.S. citizen, or an entity established or organized under the laws of a State or the United States. A ''non-U.S. person'' was defined as a person who did not satisfy either of these criteria.

As described in greater detail below, a bank is generally required to obtain a U.S. taxpayer identification number from a customer who opens a new account. However, if the customer is a non-U.S. person and does not have such a number, the bank may obtain an identification number from some other form of government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

Several commenters suggested that it would be less confusing to bankers if ''U.S. person'' meant both a U.S. citizen and a resident alien, consistent with the definition of this term used in the Internal Revenue Code (IRS definition).[18] A few commenters criticized the proposed definition because it would require banks to establish whether a customer is or is not a U.S. citizen.

Treasury and the Agencies believe that the proposed definition of ''U.S. person'' is a better standard for purposes of this final rule than the IRS definition. Adoption of the IRS definition of ''U.S. person'' would require bank staff to distinguish among various tax and immigration categories in connection with any type of account that is opened. Under the proposed definition, a bank will not necessarily need to establish whether a potential customer is a U.S. citizen. The bank will have to ask each customer for a U.S. taxpayer identification number (social security number, employer identification number, or individual taxpayer identification number). If a customer cannot provide one, the bank may then accept alternative forms of identification. For these reasons, the definition is adopted as proposed.

Section 103.121(b) Customer Identification Program: Minimum Requirements

Section 103.121(b)(1) General Rule. The proposed rule required each bank to implement a CIP that is appropriate given the bank's size, location, and type of business. The proposed rule required a bank's CIP to contain the statutorily prescribed procedures, described these procedures, and detailed certain minimum elements that each of the procedures must contain. In addition, the proposed rule required that the CIP be written and that it be approved by the bank's board of directors or a committee of the board.

The proposed rule also stated that the CIP must be incorporated into the bank's BSA [19] compliance program and should not be a separate program. A bank's BSA compliance program must be written, approved by the board, and noted in the bank's minutes. It must include (1) internal policies, procedures, and controls to ensure ongoing compliance; (2) designation of a compliance officer; (3) an ongoing employee training program; and (4) an independent audit function to test programs. The preamble for the proposal explained that the CIP should be incorporated into each of these four elements of a bank's BSA program.

Most commenters agreed with the proposal's approach of allowing banks to develop risk-based programs tailored to their specific operation, though some of these commenters recommended that Treasury and the Agencies adopt an entirely risk-based approach without any minimum requirements while others recommended a more prescriptive approach. Many commenters suggested that Treasury and the Agencies clarify the extent to which a bank could rely on a third party, especially an affiliate, to perform some or all aspects of its CIP.

Other commenters focused on the requirement that a bank's board of directors approve the CIP. These commenters urged Treasury and the Agencies to adopt a regulation that states that the role of a bank's board of directors need only be to approve broad policy rather than the specific methods or actual procedures that will be a part of a bank's CIP. One commenter recommended that the governing body of a financial institution be permitted to delegate its responsibility to approve the CIP.

The final rule attempts to strike an appropriate balance between flexibility and detailed guidance by allowing a bank broad latitude to design and implement a CIP that is tailored to its particular business practices while providing a framework of minimum standards for identifying each customer, as the Act mandates. Following the description of the procedures and minimum requirements for each element of a bank's CIP (identity verification, recordkeeping, comparison with government lists, and customer notice), the final rule contains a new section describing the extent to which a bank may rely on a third party to perform these elements, described in detail below.

The final rule removes the requirement that the bank's board of directors or a committee of the board must approve the bank's CIP because this requirement is redundant. A bank's BSA compliance program must already be approved by the board. Treasury and the Agencies regard the addition of a CIP to the bank's BSA compliance program to be a material change in the BSA compliance program that will require board approval. The board of director's responsibility to oversee bank compliance with section 326 of the Act

[17] As a foreign branch of an insured U.S. bank is no longer a ''bank'' for purposes of this rule, a customer of a bank's foreign branch will no longer be ''a person who has an existing account with the bank.'' Therefore, the bank must verify the identity of a customer of its foreign branch in accordance with its CIP if such a customer opens a new account in the U.S.

[18] 26 U.S.C. 7701(a)(30)(A).

[19] *See* footnote 10, supra.

is a part of a board's conventional supervisory BSA compliance responsibilities that cannot be delegated to bank management. Therefore, a bank's board of directors must be responsible for approving a CIP described in detail sufficient for the board to determine that (1) the bank's CIP contains the minimum requirements of this final rule; and (2) the bank's identity verification procedures are designed to enable the bank to form a reasonable belief that it knows the true identity of the customer. Nevertheless, responsibility for the development, implementation, and day-to-day administration of the CIP may be delegated to bank management.

The final rule will apply to some non-Federally regulated banks that are not yet subject to an anti-money laundering compliance program requirement.[20] Therefore, the final rule only requires that the CIP be a part of a bank's anti-money laundering program once a bank becomes subject to an anti-money laundering compliance program requirement.[21]

Section 103.121(b)(2) Identity Verification Procedures. The proposed rule provided that each bank must have a CIP that includes procedures for verifying the identity of each customer, to the extent reasonable and practicable, based on the bank's assessment of certain risks. The proposed rule stated that these procedures must enable the bank to form a reasonable belief that it knows the true identity of the customer.

Some commenters recommended that the identity verification requirement be waived for new customers that are well known to a senior officer of the bank. Some of these commenters endorsed such a waiver provided that a bank employee could provide ''an affidavit of identity'' on behalf of the customer.

One commenter criticized the standard requiring a bank to have identity verification procedures ''that enable the bank to form a reasonable belief that it knows the true identity of the customer'' as too subjective. This commenter suggested that a better standard would be lack of affirmative notice of deficiency in the identity process. Another commenter suggested that the rule make clear that a bank is only required to verify a customer's identity, to the extent reasonable and practical, in order to establish that it has a reasonable basis for knowing the true identity of its customer.

The final rule provides that a bank's CIP must include risk-based procedures for verifying the identity of each customer [22] to the extent reasonable and practicable. The final rule also states that the procedures must enable the bank to form a reasonable belief that it knows the true identity of the customer. As section 326 of the Act states, a bank's affirmative obligation to verify the identity of its customer applies to ''any person'' rather than only to a person whose identity is suspect, as suggested by one commenter. Furthermore, Treasury and the Agencies have determined that the statutory obligation to ''*verify* the identity of any person'' requires the bank to implement and follow procedures that allow the bank to have a reasonable belief that it knows the true identity of the customer.

Given the flexibility built into the final rule, Treasury and the Agencies believe that it is not appropriate to provide special treatment for new customers known to bank personnel. In addition, permitting reliance on bank personnel to attest to the identity of a customer may be subject to manipulation. Accordingly, the final rule does not establish different rules for customers who are known to bank personnel.

The final rule requires the identity verification procedures to be based upon relevant risks, including those presented by the types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, and the types of identifying information available. In addition to these risk factors, which are specifically identified in section 326, the final rule states that the procedures should take into account the bank's size, location, and type of business or customer base, additional factors mentioned in the Act's legislative history.[23]

Section 103.121(b)(2)(i) Customer Information Required. The proposed rule required that a bank's CIP must contain procedures that specify the identifying information the bank must obtain from a customer. It stated that, at a minimum, a bank must obtain from each customer the following information prior to opening an account: (1) Name; (2) address (a residential and mailing address for individuals, and principal place of business and mailing address for a person other than an individual); (3) date of birth for individuals; and (4) an identification number.

Treasury and the Agencies received a variety of comments criticizing the requirement that a bank obtain certain minimum identifying information prior to opening an account. Some commenters, including a trade association representing large financial institutions, recommended that a bank be permitted to open an account for a customer who lacks some of the minimum identifying information, provided that the bank has formed a reasonable belief that it knows the true identity of the customer. Credit card banks explained that the minimum information requirement would create problems for retailers that offer credit cards at the point of sale. These commenters stated that retailers were not likely to have the means to record identifying information other than what is currently collected. They suggested that when there are systems in place to identify customers and detect suspicious transactions, the rule should require only the collection of information that the credit card bank or card issuer deems necessary and appropriate to identify the customer.

Other commenters stated that the rule should not require a bank to obtain the minimum identifying information prior to account opening in every instance. Some of these commenters suggested that a bank be permitted to obtain the required information within a reasonable time after the account is opened. Some commenters suggested that the rule permit banks to obtain identifying information from a party other than the customer. This would arise, for example, when a bank offers a credit card based on information obtained from a credit reporting agency. Other commenters suggested that a bank also be required to obtain information about a customer's occupation, profession or business, as this information is needed by a bank that intends to file a report of transactions in currency or a suspicious activities report on the customer.

Consistent with the proposal, the final rule provides that a bank's CIP must contain procedures that specify the identifying information that the bank must obtain from each customer prior to opening an account. In addition, the rule specifies the four basic categories of information that a bank must obtain from the customer prior to opening an account. Treasury and the Agencies believe that requiring banks to gather these standard forms of information prior to opening an account is not overly burdensome because such identifying information is routinely

[20] *See* footnote 10, *supra.*

[21] The final rule therefore provides that until such time as credit unions, private banks, and trust companies without a Federal functional regulator are subject to such a program, their CIPs must be approved by their boards of directors.

[22] Other elements of the bank's CIP, such as procedures for recordkeeping or checking of government lists, are requirements that may not vary depending on risk factors.

[23] H.R. Rep. No. 107–250, pt. 1, at 62 and 63 (2001).

gathered by most banks in the account opening process and is required by other sections of 31 CFR part 103. Of course, based upon an assessment of the risks described above, a bank may require a customer to provide additional information to establish the customer's identity.

Treasury and the Agencies acknowledge that imposing this requirement on banks that offer credit card accounts is likely to alter the manner in which they do business by requiring them to gather additional information beyond that which they currently obtain directly from a customer who opens an account at the point of sale or by telephone. Treasury and the Agencies are mindful of the legislative history of section 326, which indicates that Congress expected the regulations implementing this section to be appropriately tailored for accounts opened in situations where the account holder is not physically present at the financial institution and that the regulations should not impose requirements that are burdensome, prohibitively expensive, or impractical.[24]

Therefore, Treasury and the Agencies have included an exception in the final rule for credit card accounts only, which would allow a bank broader latitude to obtain some information from the customer opening a credit card account, and the remaining information from a third party source, such as a credit reporting agency, prior to extending credit to a customer. Treasury and the Agencies recognize that these practices have produced an efficient and effective means of extending credit with little risk that the lender does not know the identity of the borrower.

Treasury and the Agencies also received comments on the advisability of requiring banks to collect the specific identifying information (name, date of birth, address, and identification number), as would have been required under the proposed rule. With respect to obtaining the customer's name, one commenter recommended that based on Texas law and banks' experience, a bank should be required to obtain the name under which the customer is doing business and the customer's legal name. The final rule continues to require that the bank obtain the customer's name, meaning a legal name that can be verified. As noted above, this is a minimum requirement, and a bank may also need to obtain the name under which a person does business in order to establish a reasonable belief it knows the true identity of the customer.

One trade association suggested that banks be permitted to make a risk-based determination before requiring a customer to provide date of birth because many customers would prefer not to share this information. One commenter stated that date of birth is not an important identifying characteristic and should be deleted. Another commenter stated that credit card issuers do not request this information because it can raise fair lending issues. Finally, a few commenters noted that standardized mortgage applications require age rather than date of birth and would have to be altered.

The final rule provides that a bank must obtain the date of birth for a customer who is an individual. Treasury and the Agencies believe that date of birth is an important identifying characteristic and can be used to provide a bank or law enforcement with an additional means to distinguish between customers with identical names. However, the required collection and retention of information about a customer's date of birth does not relieve the bank from its obligations to comply with anti-discrimination laws or regulations, such as the prohibition in the Equal Credit Opportunity Act against discrimination in any aspect of a credit transaction on the basis of age or other prohibited classification. Banks collecting date of birth from individual customers should be able to take reasonable measures to convert this information into age for purposes of the forms used in the secondary mortgage market given the delayed compliance date for the final rule.

Many commenters criticized the requirement that a bank obtain both the customer's physical and mailing address, if different. Most commenters urged Treasury and the Agencies to eliminate the requirement that the customer provide a physical address. Some of these commenters stated that this requirement could interfere with the ability of certain segments of the population to obtain a bank account, such as members of the military, persons who reside in mobile homes with no fixed address, and truck drivers who do not have a physical address. Banks that offer credit card accounts and card issuers stated that the address requirement would be extremely burdensome because they would have to change the manner in which they do business, and in some cases, credit card banks currently do not have the capacity to collect both addresses. Some of these commenters stated that new credit card customers are reluctant to give more than one address and, therefore, it would be difficult to obtain this information from customers. A trade association representing credit card banks asserted that customers may have a legitimate reason for handling correspondence through post office boxes and should not have to provide a physical address. This commenter asserted that requiring the customer to provide a physical address will discourage the provision of financial services to the unbanked and will prevent a victim of identity theft from using an alternative to an unsecured home mailbox. Another commenter noted that the physical address of a customer's principal place of business may not be relevant if the bank is working with a customer's local office. This commenter recommended that the rule simply permit the bank to obtain the customer's street address. Credit card banks and issuers urged Treasury and the Agencies to make the requirement that a bank obtain the customer's physical address optional.

Section 326 of the Act requires Treasury and the Agencies to prescribe regulations that require financial institutions to implement ''reasonable procedures.'' Accordingly, under the final rule, a bank will not be required to obtain more than a single address for a customer. Nonetheless, Treasury and the Agencies believe that the identification, verification, and recordkeeping provisions of the Act, taken together, should provide appropriate resources for law enforcement agencies to investigate money laundering and terrorist financing. The final rule therefore provides that a bank generally must obtain a residential or business street address for a customer who is an individual because Treasury and the Agencies have determined that law enforcement agencies should be able to contact an individual customer at a physical location, rather than solely through a mailing address. Treasury and the Agencies recognize that this provision may be impracticable for members of the military who cannot readily provide a physical address, and other individuals who do not have a physical address but who reliably can be contacted. Accordingly, the final rule provides an exception under these circumstances that allows a bank to obtain an Army Post Office or Fleet Post Office box number, or the residential or business street address of next of kin or of another contact individual. For a customer other than an individual, such as a corporation, partnership, or trust, the bank may obtain the address of the principal place of business, local office,

[24] H.R. Rep. No. 107–250, pt. 1, at 63 (2001).

or other physical location of the customer. Of course, a bank is free to obtain additional addresses from the customer, such as the customer's mailing address, to meet its own or its customer's business needs.

The proposal required that banks obtain an identification number from customers. For U.S. persons, a bank would have been required to obtain a U.S. taxpayer identification number. For non-U.S. persons, a bank would have been required to obtain a number from various alternative forms of government-issued identification.

One commenter stated that this requirement would not be burdensome. Commenters representing certain consumer advocacy groups commended Treasury and the Agencies for providing banks with the discretion to accept alternative forms of identifying information from non-U.S. citizens. These commenters stated that this position would assist low-income immigrants in gaining financial stability. By contrast, some commenters stated that the final rule should not permit a bank to open an account for a customer using only a foreign identification number when the customer provides a U.S. address. Other commenters asked for guidance on whether a bank is permitted to accept a number from the identification document issued by a foreign government. A few commenters urged the government to require a national identification document for all individuals.

Other commenters, primarily credit card banks, stated that the requirement that a bank obtain a U.S. taxpayer identification number from U.S. persons would create considerable hardship. They stated that new credit card customers are reluctant to give out their social security numbers, especially over the telephone. They urged that banks be given the discretion to collect identifying information, other than social security numbers, when appropriate in light of consumer privacy and security concerns. In the alternative, they recommended that banks be permitted to obtain a U.S. taxpayer identification number for U.S. persons from a trusted third party source, such as a credit reporting agency.

Some commenters questioned what number to use for accounts opened in the name of a bowling league or class reunion, or to accept donations for a special cause. Other commenters questioned what number could be obtained from foreign businesses and enterprises that have no taxpayer identification number or other government-issued documentation.

The final rule provides that a bank must obtain an ''identification number'' from every customer. As discussed above, under the definition of ''customer,'' the final rule permits a bank to obtain the identification number of the individual who opens an account in the name of an individual who lacks legal capacity, such as a minor, or a civic group, such as a bowling league.

After reviewing the comments, Treasury and the Agencies have determined that requiring a bank to obtain a customer's identification number, such as a social security number, from the customer himself or herself, in every case, including over the telephone, would be unreasonable and impracticable because it would be contrary to banks' current practices and could alienate many potential customers. Accordingly, Treasury and the Agencies have adopted an exception for credit card accounts that will permit a bank offering such accounts to acquire information about the customer, including an identification number, from a trusted third party source prior to extending credit to the customer, rather than having to obtain this information directly from the customer prior to opening an account.

The final rule also provides that for a non-U.S. person, a bank must obtain one or more of the following: A taxpayer identification number (social security number, individual taxpayer identification number, or employer identification number); passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. This standard provides a bank with some flexibility to choose among a variety of identification numbers that it may accept from a non-U.S. person.[25] However, the identifying information the bank accepts must permit the bank to establish a reasonable belief that it knows the true identity of the customer.

Treasury and the Agencies emphasize that the final rule neither endorses nor prohibits bank acceptance of information from particular types of identification documents issued by foreign governments. A bank must decide for itself, based upon appropriate risk factors, including those discussed above (the types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, the other types of identifying information available, and the bank's size, location, and customer base), whether the information presented by a customer is reliable.

Treasury and the Agencies recognize that a foreign business or enterprise may not have a taxpayer identification number or any other number from a government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. Therefore, the final rule notes that when opening an account for such a customer, the bank must request alternative government-issued documentation certifying the existence of the business or enterprise.

The proposal also contained a limited exception to the requirement that a bank obtain a taxpayer identification number from a customer opening a new account. The exception permitted a bank to open an account for a person other than an individual (such as a corporation, partnership, or trust) that has applied for, but has not received, an employer identification number (EIN), provided that the bank obtains a copy of the application before it opens the account and obtains the EIN within a reasonable period of time after the account is established. The preamble for the proposed rule explained that this exception was included for a new business that might need access to banking services, particularly a bank account or an extension of credit, before it has received an EIN from the Internal Revenue Service.

Some commenters questioned this limited exception for certain businesses. A few commenters suggested expanding the exception to include individuals who have applied for, but have not yet received a taxpayer identification number. Another commenter stated that the exception provided no added benefit and would add to a bank's recordkeeping and monitoring burden.

Treasury and the Agencies have determined that a bank should be afforded more flexibility in situations where a person, including an individual, has applied for, but has not yet received, a taxpayer identification number. Therefore, the final rule states that instead of obtaining a taxpayer identification number from a customer prior to opening an account, the CIP may include procedures for opening an account for a customer (including an individual) that has applied for, but has not received, a taxpayer identification

[25] The rule provides this flexibility because there is no uniform identification number that non-U.S. persons would be able to provide to a bank. *See* Treasury Department, ''A Report to Congress in Accordance with Section 326(b) of the USA PATRIOT Act,'' October 21, 2002.

number.[26] To lessen the recordkeeping burden for a bank that elects to use this exception, the final rule also provides that the bank's CIP need only include procedures requiring the bank to confirm that the application was filed before the customer opens the account and to obtain the taxpayer identification number within a reasonable period of time after the account is opened. Thus, a bank will be able to exercise its discretion [27] to determine how to confirm that a customer has filed an application for a taxpayer identification number rather than having to keep a copy of the application on file.

Section 103.121(b)(2)(ii) Customer Verification. The proposed rule provided that the CIP must contain risk-based procedures for verifying the information that the bank obtains in accordance with § 103.121(b)(2)(i), within a reasonable period of time after the account is opened.[28] The proposed rule also described when a bank is required to verify the identity of existing customers.

Several commenters asked Treasury and the Agencies to underscore that these verification procedures may be risk-based by noting that a bank may verify less than all of the identifying information provided by the customer. Many commenters noted that there is currently no reliable, efficient, or effective means of verifying a customer's social security number. Some of these commenters asked the government to establish a method that would permit banks to establish the authenticity and accuracy of a customer's name and taxpayer identification number.

Treasury and the Agencies recognize that there currently is no method that would permit a bank to verify, for example, a taxpayer identification, passport or alien identification number through an official source. Accordingly, the final rule provides that a bank's CIP must contain procedures for verifying the *identity* of the customer, ''using the information obtained in accordance with paragraph (b)(2)(i),'' namely, the identifying information obtained by the bank. Thus, a bank need not establish the accuracy of every element of identifying information obtained but must do so for enough information to form a reasonable belief it knows the true identity of the customer.

Some commenters stated that they appreciated the flexibility of the proposal permitting an institution to determine how soon identity must be verified. Other commenters asked Treasury and the Agencies to clarify what is a ''reasonable period of time.'' As stated in the preamble for the proposal, Treasury and the Agencies believe that the amount of time it will take an institution to verify a customer's identity may depend upon various factors, such as the type of account opened, whether the customer is physically present when the account is opened, and the type of identifying information available. For the same reasons, the final rule provides banks with the flexibility necessary to accommodate a wide range of situations by stating that the bank must verify the identifying information within a reasonable time after the account is opened.[29]

As discussed above in the definition section, many commenters criticized the proposed approach regarding verification of existing customers that open new accounts. The final rule addresses these concerns by modifying the definition of ''customer'' to exclude a person who has an existing account with the bank if the bank has a reasonable belief that it knows the true identity of the person.

Many commenters urged that the final rule continue to allow, but not mandate, documentary verification. A few commenters requested that the final rule provide additional guidance on verification. Some commenters asked that the final rule clarify that a bank may choose to use only documentary methods and may refuse to open an account using other methods.

The final rule addresses these comments by stating that a bank's CIP's verification procedures must describe when the bank will use documents, non-documentary methods, or a combination of both methods to verify a customer's identity.

Section 103.121(b)(2)(ii)(A) Verification Through Documents. The proposed rule provided that the CIP must contain procedures describing when the bank will verify identity through documents and setting forth the documents that the bank will use for this purpose. It then gave examples of documents that could be used to verify the identity of individuals and other persons such as corporations, partnerships, and trusts.

Most commenters noted that banks do not have the means to authenticate or validate documents provided by their customers and urged Treasury and the Agencies to clarify that document authentication is not a CIP requirement. Treasury and the Agencies wish to confirm that once a bank has obtained and verified the identity of the customer through a document such as a driver's license or passport, the bank will not be required to take steps to determine whether the document has been validly issued. A bank generally may rely on government-issued identification as verification of a customer's identity; however, if a document shows obvious indications of fraud, the bank must consider that factor in determining whether it can form a reasonable belief that it knows the customer's true identity.

Some commenters also asked that Treasury and the Agencies provide more examples and discuss appropriate types of documentary identification in the final rule or in separate guidance that banks may easily access. Commenters asked whether a utility bill, or library card addressed to the same physical address and name of the person seeking the account, or a foreign identification card, such as a foreign voter registration card or driver's license, would be acceptable. Some commenters questioned whether copies of documents would suffice.

Given the recent increases in identity theft and the availability of fraudulent documents, Treasury and the Agencies agree with a commenter who suggested that the value of documentary verification is enhanced by redundancy. The rule gives examples of types of documents that are considered reliable. However, a bank is encouraged to obtain more than one type of documentary verification to ensure that it has a reasonable belief that it knows the customer's true identity. Moreover, banks are encouraged to use a variety of methods to verify the identity of a customer, especially when the bank does not have the ability to examine original documents.

The final rule attempts to strike the appropriate balance between the benefits

[26] This position is analogous to that in regulations issued by the Internal Revenue Service (IRS) concerning ''awaiting-TIN [taxpayer identification number] certificates.'' The IRS permits a taxpayer to furnish an ''awaiting-TIN certificate'' in lieu of a taxpayer identification number to exempt the taxpayer from the withholding of taxes owed on reportable payments (*i.e.*, interest and dividends) on certain accounts. *See* 26 CFR 31.3406(g)–3.

[27] For example, the bank may wish to examine a copy of the application filed.

[28] The preamble for the proposed rule noted that, although an account may be opened, it is common practice among banks to place limits on the account, such as by restricting the number of transactions or the dollar value of transactions, until a customer's identity is verified. Therefore, the proposed regulation provided the bank with the flexibility to use a risk-based approach to determine how soon identity must be verified.

[29] It is possible that a bank would, however, violate other laws by permitting a customer to transact business prior to verifying the customer's identity. *See, e.g.*, 31 CFR part 500 (regulations of Treasury's Office of Foreign Asset Control (OFAC) prohibiting transactions involving designated foreign countries or their nationals).

of requiring additional documentary verification and the burdens that may arise from such a requirement by providing that a bank's CIP must state the documents that a bank will use. This will require each bank to conduct its own risk-based analysis of the types of documents it believes will enable it to know the true identity of its customers.

The final rule continues to provide an illustrative list of identification documents. For an individual, these may include an unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport. For a person other than an individual, these may include documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or a trust instrument.

Some commenters questioned whether the examples of identification documents given for persons other than individuals would be reliable. One commenter questioned whether trust documents alone would be sufficient verification of identity. Another commenter suggested allowing banks to rely on a certification by the trustee, or an appropriate legal opinion, rather than the trust instrument to verify the existence of a trust. Someone else suggested that banks should be allowed to rely on documentation consisting of evidence that a business is either publicly traded or is authorized to do business in a state or the United States.

The examples provided in the final rule were intended only to illustrate the documents a bank might use to verify the identity of a customer that is a corporation, partnership, or trust. A bank may use other documents, provided that they allow the bank to establish that it has a reasonable belief that it knows the true identity of its customer. Accordingly, the final rule makes no significant changes to the examples.

Section 103.121(b)(2)(ii)(B) Non-Documentary Verification. Recognizing that some accounts are opened by telephone, by mail, and over the Internet, the proposed rule provided that a bank's CIP also must contain procedures describing what non-documentary methods the bank will use to verify identity and when the bank will use these methods (whether in addition to, or instead of, relying on documents). The preamble for the proposed rule also noted that even if the customer presents identification documents, it may be appropriate to use non-documentary methods as well.

The proposed rule gave examples of non-documentary verification methods that a bank may use, including contacting a customer after the account is opened; obtaining a financial statement; comparing the identifying information provided by the customer against fraud and bad check databases to determine whether any of the information is associated with known incidents of fraudulent behavior (negative verification); comparing the identifying information with information available from a trusted third party source, such as a credit report from a consumer reporting agency (positive verification); and checking references with other financial institutions. The preamble for the proposed rule stated that a bank also may wish to analyze whether there is logical consistency between the identifying information provided, such as the customer's name, street address, ZIP code, telephone number, date of birth, and social security number (logical verification).

The proposal required that the procedures address situations where an individual, such as an elderly person, legitimately is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard; the bank is not familiar with the documents presented; the account is opened without obtaining documents; the account is not opened in a face-to-face transaction, for example over the phone, by mail, or through the Internet; and the type of account increases the risk that the bank will not be able to verify the true identity of the customer through documents.

Several commenters asked for additional guidance regarding when non-documentary verification methods should be used in addition to documentary verification methods and the circumstances in which only one or all of the non-documentary verification methods listed are necessary. Commenters also asked for guidance on audit methodology, and an explanation of the due diligence required for verification of accounts opened by telephone, mail, and through the Internet. A few commenters suggested that reference to verification, where a bank compares information provided by the customer with information from trusted third party sources, be expressly mentioned in the final rule.

As the large number of comments on this section illustrates, a rule that attempted to address every scenario and combination of risk-factors that a bank might confront would be extremely complex and invariably would fail to address many situations. Rather than adopt a lengthy and potentially unwieldy rule that still would not address every situation, Treasury and the Agencies have concluded that it would be more effective to adopt general principles that are fleshed out through examples. Therefore, the final rule states that for a bank relying on non-documentary verification methods, the CIP must contain procedures that describe the non-documentary methods the bank will use.

The final rule *generally* retains the illustrative list of non-documentary methods contained in the proposal. Treasury and the Agencies have clarified that one method is ''independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source,'' rather than verifying ''documentary information'' through such sources.

The final rule also retains the variety of situations that the procedures must address that were identified in the proposal, with the following two changes. First, because ''transaction'' is a defined term in 31 CFR part 103, instead of using the term ''face-to-face transaction,'' the final rule states that the procedures must address the situation where a customer opens an account without appearing in person at the bank. Second, the final clause of this provision provides that the CIP must include procedures to address situations where the bank is otherwise presented with circumstances that increase the risk that the bank will be unable to verify the true identity of a customer through documents. This clause acknowledges that there may be circumstances beyond those specifically described in this provision when a bank should use non-documentary verification procedures.

As stated in the preamble for the proposed rule, because identification documents may be obtained illegally and may be fraudulent, and in light of the recent increase in identity theft, Treasury and the Agencies encourage banks to use non-documentary methods even when the customer has provided identification documents.

Section 103.121(b)(2)(ii)(C) Additional Verification for Certain Customers. As described above, the proposed rule required the identification and verification of each signatory for an account. Most commenters objected to this requirement as overly burdensome, and, upon consideration of the points raised by the commenters, Treasury and the Agencies agree that it is appropriate

to delete it. For the reasons discussed below, however, the rule does require that a bank's CIP address the circumstances in which it will obtain information about such individuals in order to verify the customer's identity. Treasury and the Agencies believe that while the majority of customers may be verified adequately through the documentary or non-documentary verification methods described in paragraphs (b)(2)(ii)(A) and (B), there may be instances where this is not possible. The risk that the bank will not know the customer's true identity may be heightened for certain types of accounts, such as an account opened in the name of a corporation, partnership, or trust that is created or conducts substantial business in a jurisdiction that has been designated by the United States as a primary money laundering concern or has been designated as non-cooperative by an international body.

Obtaining sufficient information to verify a customer's identity can reduce the risk that a bank will be used as a conduit for money laundering and terrorist financing. Treasury and the Agencies believe that a bank must identify customers that pose a heightened risk of not being properly identified, and a bank's CIP must prescribe additional measures that may be used to obtain information about the identity of the individuals associated with the entity in whose name such an account is opened when standard documentary and non-documentary methods prove to be insufficient.

For these reasons, the requirement to verify the identity of signatories has been replaced by a new provision in the final rule that requires that a bank's CIP address situations where, based on the bank's risk assessment of a new account opened by a customer that is not an individual, the bank also will obtain information about individuals with authority or control over such account, including signatories, in order to verify the customer's identity. This additional verification method will only apply when the bank cannot adequately verify the customer's identity using the documentary and non-documentary verification methods described in (b)(2)(ii)(A) and (B). Moreover, a bank need not undertake any additional verification if it chooses not to open an account when it cannot verify the customer's identity using standard documentary and non-documentary verification methods.

Section 103.121(b)(2)(iii) Lack of Verification. The proposed rule stated that a bank's CIP must include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of a customer. The preamble for the proposed rule listed what these procedures should include. In addition, the proposal stated that a bank should only maintain an account for a customer when it can form a reasonable belief that it knows the customer's true identity.[30]

The final rule retains the general requirement that a bank's CIP include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of the customer. However, the rule text itself now states that the procedures should describe the following: when a bank should not open an account for a potential customer; the terms under which a customer may use an account while the bank attempts to verify the customer's identity; when the bank should close an account after attempts to verify a customer's identity have failed; and when the bank should file a Suspicious Activity Report in accordance with applicable law and regulation.

One commenter stated that requiring a bank to close an account if it cannot verify a customer's identity would conflict with state laws and would subject the bank to legal liability. The commenter urged that if this provision is retained, the final rule also should shield banks from state regulatory and borrower liability in these circumstances. Other commenters asked that Treasury and the Agencies clarify that further investigation that results in failure to open an account will not trigger adverse action requirements under the FCRA, 15 U.S.C. 1681 *et seq.* or the Equal Credit Opportunity Act (ECOA), 15 U.S.C. 1691 *et seq.*

The final rule does not specifically require a bank to close the account of a customer whose identity the bank cannot verify, but instead leaves this determination to the discretion of the bank. Treasury and the Agencies have determined that there is no statutory basis to create a safe harbor that would shield banks from state regulatory or borrower liability if a bank should choose to close a customer's account. Any such closure should be consistent with the bank's existing procedures for closing accounts in accordance with its risk management practices. Treasury and the Agencies also note that a bank must comply with other applicable laws and regulations, such as the adverse action provisions under ECOA and the FCRA, when determining not to open an account because it cannot establish a reasonable belief that it knows the true identity of the customer.[31]

Section 103.121(b)(3) Recordkeeping

Section 103.121(b)(3)(i) Required Records. The proposed rule set forth recordkeeping procedures that must be included in a bank's CIP. Under the proposal, a bank would have been required to maintain a record of the identifying information provided by the customer. Where a bank relies upon a document to verify identity, the proposal would have required the bank to maintain a copy of the document that the bank relied on that clearly evidences the type of document and any identifying information it may contain. The bank also would have been required to record the methods and result of any additional measures undertaken to verify the identity of the customer. Last, the bank would have been required to record the resolution of any discrepancy in the identifying information obtained.

This section of the proposed rule prompted the most comment. Though one commenter felt that the recordkeeping requirements in the proposed rule were weak, almost all other commenters identified the proposed documentation and record retention requirements as overly burdensome. Commenters urged Treasury and the Agencies to permit a bank to record the information from the documents obtained rather than requiring banks to maintain copies of these documents for the life of the account. Commenters generally argued that it would be difficult and very burdensome to store and retrieve copies of documents used to verify the identity of the customer. In addition, some commenters noted that many kinds of identification documents, particularly some new driver's licenses, have security features that prevent them from being copied legibly. Other commenters stated that copies of documents would be difficult to safeguard and could facilitate identity theft.

Commenters stated that requiring banks to keep copies of documents would substantially deviate from current banking practice and would violate certain states' laws. Banks offering credit card accounts through retailers, who require the customer to

[30] The preamble also explained that there are some exceptions to this basic rule. For example, a bank may maintain an account at the direction of a law enforcement or intelligence agency, even though the bank does not know the true identity of the customer.

[31] *See* 12 CFR 202.9(b) (Federal Reserve Regulation B that prescribes the form of ECOA notice and statement of specific reasons); 15 U.S.C. 1681m (FCRA provision that provides for duties of users taking adverse actions on the basis of information contained in consumer reports from other third parties or affiliates).

provide identifying documents at the point of sale, strenuously opposed this requirement if it were interpreted to cover documents presented to the merchant. These commenters stated that copy machines are not usually available at the point of sale, and that the rule as proposed would require merchants to purchase large numbers of additional copy machines. The commenters also anticipated that consumers would be greatly inconvenienced by this requirement and might have to endure lengthy waits during any busy shopping season. These commenters questioned whether the risks of money-laundering and the financing of terrorism through retail store credit cards, which generally have relatively low credit limits, restrictions on pre-payment, and other features to detect fraud, warrant the imposition of these additional costs.

Other commenters stated that requiring banks to keep copies of documents that have pictures, such as driver's licenses, could expose the bank to allegations of unlawful discrimination, even if the retention of this information were not prohibited under ECOA. Some banks objected to this requirement on the grounds that it directly conflicted with the position that the Agencies have traditionally taken on this issue, including the criticism of banks that have retained such information in their files when extending credit.

Other commenters asked that a bank be permitted to record the processes and procedures generally used for verification rather than being required to keep records of the methods used and the resolution for each and every account, especially where the bank uses standardized procedures for all customers and could demonstrate that these procedures were applied. Some commenters suggested that the final rule permit banks to use a risk-based approach for recordkeeping.

In light of the comments received, Treasury and the Agencies have reconsidered and modified the recordkeeping requirements of the proposed rule. The final rule provides that a bank's CIP must include procedures for making and maintaining a record of all information obtained under the procedures implementing the requirement that a bank develop and implement a CIP. However, the final rule affords banks significantly more flexibility than did the recordkeeping provisions contained in the proposal. Under the final rule, a bank's records are to include ''a description,'' rather than a copy, of any document upon which the bank relied in order to verify the identity of the customer, noting the type of document, any identification number contained in the document, the place of issuance, and, if any, the date of issuance and expiration date. The final rule also clarifies that the record must include ''a description'' of the methods and results of any measures undertaken to verify the identity of the customer, and of the resolution of any ''substantive'' discrepancy discovered when verifying the identifying information obtained, rather than any documents generated in connection with these measures.

As Treasury and the Agencies indicated in the preamble for the proposal, nothing in the rule modifies, limits, or supersedes section 101 of the Electronic Signatures in Global and National Commerce Act, Pub. L. 106–229, 114 Stat. 464 (15 U.S.C. 7001) (E-Sign Act). Thus, a bank may use electronic records to satisfy the requirements of this final rule, as long as the records are accurate and remain accessible in accordance with 31 CFR 103.38(d).

Section 103.121(b)(3)(ii) Retention of Records

The proposal required a bank to retain all of the records specified in the recordkeeping provision for five years after the date the account is closed.

This requirement prompted strenuous objections. Assuming that copies of the documents used to verify the identity of the customer would have to be retained, commenters asserted that retaining records until five years after the account is closed would be very burdensome. Some commenters noted that imaging is not a routine practice for community banks and could be costly. Banks offering credit card accounts stated that the record retention requirement would require a change in forms, processes, and systems, while also increasing storage costs. As credit cards do not have a specific term, commenters noted that banks would be required to keep these records forever, unless they are culled manually. Some commenters suggested that the retention period be shortened, with suggestions ranging from one to three years after the account is closed, while other commenters suggested that the period be shortened to five years from when the account is opened. Many commenters stated that two years from when the information is obtained would be consistent with other regulatory requirements, such as the record retention requirements for an application for an extension of credit subject to ECOA (12 CFR 202.12(b)).

By eliminating the requirement that a bank retain copies of the documents used to verify the identity of the customer, Treasury and the Agencies believe that the final rule largely addresses the main concern of these commenters. However, Treasury and the Agencies also have determined that, while the identifying information provided by the customer should be retained, there is little value in requiring banks to retain the remaining records for five years after an account is closed because this information is likely to have become stale. Therefore, the final rule now prescribes a bifurcated record retention schedule that is consistent with the general five-year retention requirement in 31 CFR 103.38. First, the bank must retain the information referenced in paragraph (b)(3)(i)(A) (that is, information obtained about a customer), for five years after the date the account is closed or, in the case of credit card accounts, five years after the account is closed or becomes dormant. Second, the bank need only retain the records that it must make and maintain under the remaining parts of the recordkeeping provision, paragraphs (b)(3)(i)(B), (C), and (D) (that is, information that verifies a customer's identity) for five years after the record is made.

Section 103.121(b)(4) Comparison with Government Lists. The proposed rule required a bank to have procedures for determining whether the customer appears on any list of known or suspected terrorists or terrorist organizations provided to the bank by any Federal government agency. In addition, the proposal stated that the procedures must ensure that the bank follows all Federal directives issued in connection with such lists.

Most commenters were concerned about how a bank would be able to determine what lists should be checked for purposes of this provision and how these lists would be made available. Some commenters asked that the final rule confirm that a bank will not have an affirmative duty to *seek out* all lists compiled by the Federal government and would only be required to check lists *provided* to it by the Federal government. Some commenters noted that lists published by OFAC are published but are not provided to financial institutions.[32] Many commenters urged that all lists within the meaning of section 326 of the Act,

[32] Nevertheless, the legislative history for this provision indicates that the lists Congress intended financial institutions to consult ''are those already supplied to financial institutions by the Office of Foreign Asset Control (OFAC), and occasionally by law enforcement and regulatory authorities, as in the days immediately following the September 11, 2001, attacks on the World Trade Center and the Pentagon.'' H.R. Rep. No. 107–250, pt. 1, at 63 (2001).

be centralized, issued by a single designated government agency, and provided to financial institutions in a commonly used electronic format. Some of these commenters suggested that instead of providing multiple lists, the government set up a single Web site that would permit a bank to search for a name alphabetically, similar to the OFAC list. Other commenters asked Treasury and the Agencies to clarify what action a bank should take when a customer appears on a list.

Commenters also asked for guidance regarding the timing of when the comparison must be performed and asked whether the lists could be checked after an account is opened. Some commenters stated that there is no practical way for a financial institution to check lists prior to opening an account.

The final rule states that a bank's CIP must include procedures for determining whether the customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. Because Treasury and the Federal functional regulators have not yet designated any such lists, the final rule cannot be more specific with respect to the lists banks must check in order to comply with this provision. However, banks will not have an affirmative duty under this regulation to seek out all lists of known or suspected terrorists or terrorist organizations compiled by the Federal government. Instead, banks will receive notification by way of separate guidance regarding the lists that must be consulted for purposes of this provision.

Treasury and the Agencies have modified this provision to give guidance as to *when* a bank must consult a list of known or suspected terrorists or terrorist organizations. The final rule states that the CIP's procedures must require the bank to make a determination regarding whether a customer appears on a list ''within a reasonable period of time'' after the account is opened, or earlier if required by another Federal law or regulation or by a Federal directive issued in connection with the applicable list.

The final rule provides that a bank's CIP must contain procedures requiring the bank to follow all Federal directives issued in connection with such lists. Again, because there are no lists that have been designated under this provision as yet, the final rule cannot provide more guidance in this area.

Section 103.121(b)(5) Customer Notice. The proposed rule would have required a bank's CIP to include procedures for providing bank customers with adequate notice that the bank is requesting information to verify their identity. The preamble for the proposal stated that a bank could satisfy that notice requirement by generally notifying its customers about the procedures the bank must comply with to verify their identities. It stated that the bank could post a notice in its lobby or on its Internet website, or provide customers with any other form of written or oral notice.

Treasury and the Agencies received a large number of comments on this provision. Some commenters did not agree that section 326 of the Act requires notice to bank customers. Some of these commenters suggested that a bank's request for identifying information should be considered adequate notice. Other commenters did not question this requirement and stated that they appreciated the flexibility of this provision. However, a great many commenters asked for additional guidance on the content and timing of the notice and specifically requested that the final rule provide model language so that all institutions represent the requirements of section 326 in the same manner and the adequacy of notice is not left to the interpretation of individual examiners.

Section 326 provides that the regulations issued ''shall, at a minimum, require financial institutions to implement, and customers (after being given adequate notice) to comply with reasonable procedures'' that satisfy the statute. Based upon this statutory requirement, the final rule requires a bank's CIP to include procedures for providing bank customers with adequate notice that the bank is requesting information to verify their identities. However, the final rule provides additional guidance regarding what constitutes adequate notice and the timing of the notice requirement.

The final rule states that notice is adequate if the bank generally describes the identification requirements of the final rule and provides notice in a manner reasonably designed to ensure that a customer views the notice, or is otherwise given notice, before opening an account. The final rule also states that depending upon the manner in which an account is opened, a bank may post a notice in the lobby or on its website, include the notice on its account applications, or use any other form of oral or written notice. In addition, the final rule includes sample language that, if appropriate, will be deemed adequate notice to a bank's customers when provided in accordance with the requirements of this final rule.

Section 103.121(b)(6) Reliance on Another Financial Institution. Many commenters urged that the final rule permit a bank to rely on a third party to perform elements of the bank's CIP. For example, some commenters asked that the final rule clarify that a bank may use a third party service provider to perform tasks and keep records. Other commenters recommended that the rule should permit a third party to verify the identity of the bank's customer in indirect lending arrangements, for example, where a car dealer acting as agent of the bank extends a loan to a customer or where a mortgage broker acts on a bank's behalf. Some commenters urged that the final rule be modified to more broadly permit financial institutions to share customer identification and verification duties with other financial institutions so as to avoid each institution having to undertake duplicative customer identification efforts. Some of these commenters suggested that a bank be permitted to allocate its responsibility to verify the customer's identity by contract with another financial institution as permitted in the proposed rule for broker-dealers.

Other commenters requested that the final rule permit the CIP obligations to be performed initially by only one financial institution if a customer has different accounts with different affiliates. These commenters noted that it is common for a customer to maintain several different accounts with a financial institution and its affiliates. The same customer, for example, may have a credit card account with one affiliate, a home mortgage with another affiliate, and a brokerage account with a broker-dealer affiliate. The commenters urged that a bank be permitted to rely on customer identification and verification performed by an affiliate because it would be superfluous and unnecessarily burdensome to subject the same customer to substantially similar customer identification and verification procedures on multiple occasions. Furthermore, those commenters urged Treasury and the Agencies to allow a bank to rely on an affiliate in order to reduce the substantial costs of maintaining duplicative records regarding identity verification under the recordkeeping provisions of the rule.

Treasury and the Agencies recognize that there may be circumstances where a bank should be able to rely on the performance by another financial institution of some or all of the elements of the bank's CIP. Therefore, the final rule provides that a bank's CIP may

include procedures specifying when the bank will rely on the performance by another financial institution (including an affiliate) of any procedures of the bank's CIP and thereby satisfy the bank's obligations under the rule. Reliance is permitted if a customer of the bank is opening, or has opened, an account or has established a similar banking or business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions.

In order for a bank to rely on the other financial institution, such reliance must be reasonable under the circumstances, and the other financial institution must be subject to a rule implementing the anti-money laundering compliance program requirements of 31 U.S.C. 5318(h) and be regulated by a Federal functional regulator. The other financial institution also must enter into a contract requiring it to certify annually to the bank that it has implemented its anti-money laundering program and that it will perform (or its agent will perform) the specified requirements of the bank's CIP. The contract and certification will provide a standard means for a bank to demonstrate the extent to which it is relying on another institution to perform its CIP, and that the institution has in fact agreed to perform those functions. If it is not clear from these documents, a bank must be able to otherwise demonstrate when it is relying on another institution to perform its CIP with respect to a particular customer.

The bank will not be held responsible for the failure of the other financial institution to adequately fulfill the bank's CIP responsibilities, provided the bank can establish that its reliance was reasonable and that it has obtained the requisite contracts and certifications. Treasury and the Agencies emphasize that the bank and the other financial institution upon which it relies must satisfy all of these conditions set forth in the rule. If they do not, then the bank remains solely responsible for applying its own CIP to each customer in accordance with this regulation.

All of the Federal functional regulators are adopting comparable provisions in their respective regulations to permit such reliance. Furthermore, the Federal functional regulators expect to share information and to cooperate with each other to determine whether the institutions subject to their jurisdiction are in compliance with the conditions of the reliance provision of this final rule.

The final rule issued here does not affect a bank's authority to contract for services to be performed by a third party either on or off the bank's premises. Thus, for example, a bank may contract with a third party service provider to keep its records even when the bank does not act under the reliance provision set forth in the regulation. However, Treasury and the Agencies note that the performance of these services for Federally regulated banks [33] will be subject to regulation and examination by the Agencies under other applicable laws and regulations. *See, e.g.,* 12 U.S.C. 1867.

The final rule also does not alter a bank's authority to use an agent to perform services on its behalf. Therefore, a bank is permitted to arrange for a car dealer or mortgage broker, acting as its agent in connection with a loan, to verify the identity of its customer. However, as with any other responsibility performed by an agent, and in contrast to the reliance provision in the rule, the bank ultimately is responsible for that agent's compliance with the requirements of this final rule.

Section 103.121(c) Exemptions. The proposed rule provided that the appropriate Federal functional regulator, with the concurrence of Treasury, may by order or regulation exempt any bank or type of account from the requirements of this section. The proposal stated that, in issuing such exemptions, the Federal functional regulator and Treasury shall consider whether the exemption is consistent with the purposes of the BSA, consistent with safe and sound banking, and in the public interest. The proposal stated that the Federal functional regulator and Treasury also may consider other necessary and appropriate factors.

There were a number of comments suggesting that various types of accounts be exempted from the final rule. For example, several commenters suggested that accounts of Federal, state, and local governmental entities, public companies, and correspondent banks be exempted from the final rule. One commenter suggested that student loan programs be exempted from the rule because current safeguards are sufficient to verify the identity of student loan borrowers. Another commenter suggested that small trust companies and limited purpose banks that provide trust services be exempted from the rule, because such entities are more local in operation, would be burdened by the rule, and have fewer employees to ensure compliance. Yet another commenter suggested that the NCUA exempt credit unions from the CIP requirements.

Any suggested exemptions that Treasury and the Agencies have determined to be appropriate are incorporated into the definitions of ''account'' and ''customer'' for the reasons described above. The exemption provision of the final rule is essentially adopted as proposed with respect to banks that have a Federal functional regulator. Because the final rule will also apply to certain banks that do not have a Federal functional regulator, a new provision has been added to make clear that Treasury alone will make all determinations regarding exemptions for these institutions.

Section 103.121(d) Other Information Requirements Unaffected. The proposal provided that nothing in § 103.121 shall be construed to relieve a bank of its obligations to obtain, verify, or maintain information in connection with an account or transaction that is required by another provision in part 103. For example, if an account is opened with a deposit of more than $10,000 in cash, the bank opening the account must comply with the customer identification requirements in § 103.121, as well as with the provisions of § 103.22, which require that certain information concerning the transaction be reported by filing a Currency Transaction Report (CTR). There were no comments on this provision. Therefore, Treasury and the Agencies have adopted this provision generally as proposed, except that it has been clarified to provide that nothing in § 103.121 should be construed to relieve a bank of any of its obligations, including its obligations to obtain, verify, or maintain information in connection with an account or transaction that is required by another provision in part 103.

III. Conforming Amendments to 31 CFR 103.34

Section 103.34(a) sets forth customer identification requirements when certain types of deposit accounts are opened. Together with the proposed rule implementing section 326, Treasury, on its own authority, proposed deleting 31 CFR 103.34(a) for the following reasons.

First, the preamble for the proposal explained that Treasury regards the requirements of §§ 103.34(a)(1) and (2) as inconsistent with the intent and purpose of section 326 of the Act and incompatible with proposed section 103.121. Generally §§ 103.34(a)(1) and (2) require a bank, within 30 days after

[33] Because it lacks the specific statutory authority to regulate and examine service providers, NCUA, as a matter of safety and soundness, will require credit unions to document that their service providers fully comply with this regulation and with the credit union's customer identification program.

certain deposit accounts are opened, to secure and maintain a record of the taxpayer identification number of the customer involved. If the bank is unable to obtain the taxpayer identification number within 30 days (or a longer time if the person has applied for a taxpayer identification number), it need take no further action under § 103.34 concerning the account if it maintains a list of the names, addresses, and account numbers of the persons for which it was unable to secure taxpayer identification numbers, and provides that information to Treasury upon request. In the case of a non-resident alien, the bank is required to record the person's passport number or a description of some other government document used to determine identification. These requirements conflicted with those in proposed § 103.121 which required a bank to obtain the name, address, date of birth and an identification number from any person seeking to open a new account.

Second, § 103.34(a)(3) currently provides that a bank need not obtain a taxpayer identification number with respect to specified categories of persons [34] opening certain deposit accounts. Proposed § 103.121 did not exempt any persons from the CIP requirements. Treasury requested comment on whether any of the exemptions in § 103.34(a)(3) should apply in light of the intent and purpose of section 326 of the Act and the requirements of proposed § 103.121.

Third, § 103.34(a)(4) also provides that IRS rules shall determine whose number shall be obtained in the case of multiple account holders. In the preamble that accompanied its proposal, Treasury stated that this provision is inconsistent with section 326 of the Act, which requires that banks verify the identity of ''any'' person seeking to open an account.

In addition, Treasury proposed deleting § 103.34(b)(1) which requires a bank to keep ''any notations, if such are normally made, of specific identifying information verifying the identity of the signer [who has signature authority over an account] (such as a driver's license number or credit card number).'' Treasury stated that the quoted language in § 103.34(b)(1) is inconsistent with the proposed requirements of § 103.121. For this reason, Treasury, under its own authority, proposed to delete the quoted language.

Few comments were received regarding the proposed deletion of these provisions. Some commenters agreed that § 103.34(a) should be deleted if proposed § 103.121 were adopted. One commenter suggested that § 103.34(a) should be revised to achieve the objectives of the section 326 of the Act. One commenter representing a military bank requested continuance of the exemption for agencies and instrumentalities of the Federal government that will permit exemption of commissaries, exchanges and various military organizations. Another commenter requested maintenance of the exemption for government entities, court funds, unincorporated units of tax-exempt organizations, and school thrift programs.

Treasury has determined that given the more comprehensive requirements of the final version of § 103.121, there is no longer a need for § 103.34 (a). A number of the exemptions formerly in § 103.34(a) have now been added to § 103.121. Other exemptions conflict with the language and intent of section 326 of the Act and thus were not adopted in the final rule. While § 103.34(a) will no longer be needed once the final rule is fully effective, withdrawing the provision before October 1, 2003, would create a gap period during which banks would not be subject to a rule under the BSA requiring a customer to be identified when opening an account. Because Treasury and the Agencies do not believe such a gap period would be appropriate, the final rule—rather than withdrawing § 103.34(a)—amends the section to cut off its applicability on October 1, 2003, when § 103.121 becomes fully effective.[35]

By contrast, Treasury no longer believes that it is necessary to delete the quoted language in § 103.34(b), which requires a bank to keep ''any notations, if such are normally made, of specific identifying information verifying the identity of [a person with signature authority over an account] (such as a driver's license number or credit card number).'' The definition of ''customer'' in the final version of § 103.121 no longer includes a signatory on an account. Therefore, § 103.121 and § 103.34(b)(1) are not inconsistent and the records required to be kept in accordance with § 103.34(b)(1) will still have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, and to protect against international terrorism. Therefore, the proposal to delete the quoted language in § 103.34(b)(1) is not adopted as proposed.

IV. Technical Amendment to 31 CFR 103.11(j)

Section 103.11(j), which defines the term ''deposit account,'' contains an obsolete reference to the definition of ''transaction account,'' which is defined in § 103.11(hh). Under its own authority, Treasury proposed to correct this reference. There were no comments on this proposed technical correction. Therefore, it is adopted as proposed.

V. Regulatory Analysis

A. Regulatory Flexibility Act

Under the Regulatory Flexibility Act (RFA), an agency must either prepare a Final Regulatory Flexibility Analysis (FRFA) for a final rule or certify that the final rule will not have a significant economic impact on a substantial number of small entities.[36] *See* 5 U.S.C. 604 and 605(b).

Treasury and the Agencies have reviewed the impact of this final rule on small banks. Treasury and the Agencies certify that the final rule will not have a significant economic impact on a substantial number of small entities.

First, Treasury and the Agencies believe that banks already have implemented prudential business practices and anti-money laundering

[34] The exemption applies to (i) agencies and instrumentalities of Federal, State, local, or foreign governments; (ii) judges, public officials, or clerks of courts of record as custodians of funds in controversy or under the control of the court; (iii) aliens who are ambassadors; ministers; career diplomatic or consular officers; naval, military, or other attaches of foreign embassies and legations; and members of their immediate families; (iv) aliens who are accredited representatives of certain international organizations, and their immediate families; (v) aliens temporarily residing in the United States for a period not to exceed 180 days; (vi) aliens not engaged in a trade or business in the United States who are attending a recognized college or university, or any training program supervised or conducted by an agency of the Federal Government; (vii) unincorporated subordinate units of a tax exempt central organization that are covered by a group exemption letter; (viii) a person under 18 years of age, with respect to an account opened as part of a school thrift savings program, provided the annual interest is less than $10; (ix) a person opening a Christmas club, vacation club, or similar installment savings program, provided the annual interest is less than $10; and (x) non-resident aliens who are not engaged in a trade or business in the United States.

[35] Appropriate conforming amendments are made to §§ 103.34(b)(11) and (12) to add a cross-reference to the Internal Revenue Code regarding the rules for determining what constitutes a taxpayer identification number.

[36] The RFA defines the term ''small entity'' in 5 U.S.C. 601 by reference to the definitions published by the Small Business Administration (SBA). The SBA has defined a ''small entity'' for banking purposes as a bank or savings institution with less than $150 million in assets. *See* 13 CFR 121.201. The NCUA defines ''small credit union'' as those under $1 million in assets. Interpretive Ruling and Policy Statement No. 87–2, Developing and Reviewing Government Regulations (52 FR 35231, September 18, 1987).

programs that include most of the procedures that a CIP must contain under this final rule. Banks generally undertake extensive measures to verify the identity of their customers as a matter of good business practice. In addition, Federally regulated banks already must have anti-money laundering programs that include procedures for identification, verification, and documentation of customer information.[37]

Second, although the final rule contains several requirements that will be new to banks we anticipate that the costs of implementing these requirements will not be economically significant. For example, the recordkeeping requirements in the final rule may impose some costs on banks to the extent that the information that must be maintained is not already collected and retained.[38] Treasury and the Agencies believe that the compliance burden is minimized for banks, including small banks, because the final rule vests a bank with the discretion to design and implement appropriate recordkeeping procedures, including allowing banks to maintain electronic records in lieu of (or in combination with) paper records.

The section of the final rule that requires banks to check lists of known and suspected terrorists and terrorist organizations and to follow Federal agency directives in connection with the lists is also a new requirement that will impose nominal burden, once Treasury and the Agencies publish lists that banks must consult. However, no such lists have been issued to date. Moreover, banks already must have procedures to satisfy other similar requirements. For instance, banks already have to ensure that they do not engage in transactions involving designated foreign countries, foreign nationals, and other entities prohibited under OFAC rules. *See* 31 CFR part 500. We also understand that many banks, including small banks, use electronic search tools to check lists [39] and already use identity verification software, both as part of their customer due diligence obligations under existing BSA compliance program requirements and to detect fraud.

The notice provisions of the rule also are new. However, they are very flexible and, as written, should impose only minimal costs. The final rule permits a bank to satisfy the notice requirement by choosing from a variety of low-cost measures, such as posting a sign in the lobby or on its website, by adding it to an account statement, or using any other form of written or oral notice. In addition, the amount of time that a bank will need to develop its notices will be minimal as the final rule now contains a sample notice.

Treasury and the Agencies believe that the flexibility incorporated into the final rule will permit each bank to tailor its CIP to fit its own size and needs. In this regard, Treasury and the Agencies believe that expenditures associated with establishing and implementing a CIP will be commensurate with the size of a bank. If a bank is small, the burden to comply with the proposed rule should be *de minimis*.

Most commenters on the proposed rule stated that Treasury and the Agencies had underestimated the burden imposed by the proposed rule. They highlighted aspects of the proposal that they maintained would have imposed excessive burdens and would have required banks to alter their current practices. Most comments focused on the proposed provisions requiring banks to verify the identity of signatories on accounts, to keep copies of documents used to verify a customer's identity, and to retain identity verification records for five years after an account is closed.

In drafting the final rule, Treasury and the Agencies have either eliminated or minimized the most significant burdens identified by commenters. In response to commenters, for example, the final rule eliminates signatories from the definition of ''customer,'' no longer requires a bank to keep copies of documents used to verify a customer's identity, and reduces the universe of records that must be kept for five years after an account is closed. Treasury and the Agencies have taken other steps that significantly reduce the scope of the rule and burdens of the rule. Many of these burden-reducing actions are described in the Paperwork Reduction Act discussion below.[40] As a result of these changes, the final rule is far more flexible and less burdensome than the proposed rule while still fulfilling the statutory mandates enumerated in section 326 of the Act.

Finally, Treasury and the Agencies did consider whether it would be appropriate to exempt small banks from the requirements of the rule. We do not believe that an exemption for small banks is appropriate, given the flexibility built into the rule to account for, among other things, the differing sizes and resources of banks, as well as the importance of the statutory goals and mandate of section 326. Money laundering can occur in small banks as well as large banks.

B. Paperwork Reduction Act

Certain provisions of the final rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). An agency may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. Treasury submitted the final rule to the OMB for review in accordance with 44 U.S.C. 3507(d). The OMB has approved the collection of information requirements in today's rule under control number 1506–0026.

[37] *See* footnote 10.

[38] *See, e.g.*, identification and verification of customers in connection with each share or deposit account opened (31 CFR 103.34).

[39] We believe that most banks will use technology rather than manual methods to check lists. OFAC lists are generally incorporated into bank software and, in response to bank inquiries, Treasury and the Agencies have made clear that banks are permitted to share the lists they receive pursuant to section 314 of the Act with their service providers. We expect that any lists provided under section 326 of the Act will also be provided under the same conditions.

[40] In addition to the burden-reducing measures discussed in the Paperwork Reduction Act discussion, other changes include:

[sbull] A clarification that a bank must verify the customer's *identity* using the identifying information obtained. The proposed rule would have required the bank to verify all identifying information. The elimination of the requirement that a bank must obtain a physical and a mailing address from a customer opening an account. Under the final rule, the bank is only required to obtain a physical address.

[sbull] A new provision that permits a bank to rely on another financial institution to perform its CIP under certain conditions. This provision allows financial institutions that share a customer to share customer identification and verification obligations and to reduce the cost of maintaining duplicative records required by the recordkeeping provisions of the final rule.

[sbull] A revised provision that extends to customers who are individuals the exception that permits a bank to open an account for a customer that has applied for, but has not received, a taxpayer identification number.

[sbull] A new exemption for credit card accounts from the requirement that a bank obtain identifying information from the customer prior to opening an account. In connection with credit card accounts, a bank is permitted to obtain identifying information from a third party source prior to extending credit.

[sbull] A clarification stating that the government will provide lists of known or suspected terrorists and terrorist organizations to banks. Banks will not be required to seek out this information. In addition, the rule now states that the bank may determine whether a customer appears on the list within a reasonable time after the account is opened, unless it is required to do so earlier by another Federal law, regulation, or directive.

[sbull] A transition period that permits banks a period of several months to comply with the final rule.

Collection of Information Under the Proposed Rule

The proposed rule applied only to a financial institution that is a ''bank'' as defined in 31 CFR 103.11(c),[41] and any foreign branch of an insured bank. The proposed rule required each bank to establish a written CIP that must include recordkeeping procedures (proposed § 103.121(b)(3)) and procedures for providing customers with notice that the bank is requesting information to verify their identity (proposed § 103.121(b)(5)).

The proposed rule required a bank to maintain a record of (1) the identifying information provided by the customer, the type of identification document(s) reviewed, if any, the identification number of the document(s), and a copy of the identification document(s); (2) the means and results of any additional measures undertaken to verify the identity of the customer; and (3) the resolution of any discrepancy in the identifying information obtained. It also required these records to be maintained at the bank for five years after the date the account is closed (proposed § 103.121(b)(3)).

The proposed rule also required a bank to give its customers ''adequate notice'' of the identity verification procedures (proposed § 103.121(b)(5)). The proposed rule stated that a bank could satisfy the notice requirement by posting a sign in the lobby or providing customers with any other form of written or oral notice.

Collection of Information Under the Final Rule

The final rule, like the proposed rule, requires banks to implement reasonable procedures to (1) maintain records of the information used to verify a customer's identity, and (2) provide notice of these procedures to customers. These recordkeeping and disclosure requirements are required under section 326 of the Act. However, the final rule greatly reduces the paperwork burden attributable to these requirements, as described below.

The final rule also contains a new recordkeeping provision permitting a bank to rely on another financial institution to perform some or all its CIP, under certain circumstances. Among other things, the other financial institution must provide the bank with a contract requiring it to certify annually to the bank that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) the specified requirements of the bank's CIP.

Response to Comments Received

We received approximately 500 comments on the proposed rule. Most of the commenters specifically mentioned the recordkeeping burden associated with the proposed rule. Some commenters also asked Treasury and the Agencies to clarify the meaning of ''adequate notice'' and requested that a sample notice be provided in the final rule.

Only a few commenters provided burden estimates of additional burden hours that would result from the proposed rule. However, these burden estimates did not necessarily focus on the recordkeeping and disclosure requirements in the proposal and ranged from 200 extra hours per year to 9,000 additional hours. Treasury and the Agencies believe that the final rule substantially addresses the concerns of the commenters. Specific concerns about paperwork burden have been addressed as follows:

First, the recordkeeping and disclosure burden are minimized in the final rule because Treasury and the Agencies reduced the entire scope of the final rule, by:

[sbull] Narrowing and clarifying the scope of ''account.'' The final rule specifically excludes accounts that (1) a bank acquires through an acquisition, merger, purchase of assets, or assumption of liabilities from a third party, and (2) accounts opened for the purpose of participating in an employee benefit plan established pursuant to the Employee Retirement Income Security Act of 1974. It also specifically excludes wire transfers, check cashing, and the sale of travelers checks, and any other product or service that does not lead to a ''formal banking relationship'' from the scope of the rule;

[sbull] Narrowing the definition of ''bank'' covered by the rule to exclude a bank's foreign branches; and

[sbull] Limiting and clarifying who is a ''customer'' for purposes of the final rule. The final rule now defines ''customer'' as ''a person that opens a new account'' making clear that a person who does not receive banking services, such as a person whose deposit or loan application is denied, is not a customer. The definition of customer also excludes signatories from the definition of ''customer.'' Moreover, the final rule excludes from the definition of ''customer'' the following readily-identifiable entities: A financial institution regulated by a Federal functional regulator; a bank regulated by a state bank regulator; and governmental agencies and instrumentalities and companies that are publicly traded (*i.e.*, entities described in § 103.22(d)(2)(ii)–(iv)). The final rule also excludes existing customers of the bank, provided that the bank has a reasonable belief that it knows the true identity of the person.[42]

Second, recordkeeping burden was further reduced by:

[sbull] Eliminating the requirement that a bank keep copies of any document that it relied upon in order to verify the identity of the customer and substituting a requirement that a bank's records need only include ''a description'' of any document that it relied upon in order to verify the identity of the customer. The final rule also clarifies that the records need only include ''a description'' of the methods and results of any measure undertaken to verify the identity of the customer, and of the resolution of any substantive discrepancy discovered when verifying the identifying information obtained, rather than any documents generated in connection with these measures; and

[sbull] Reducing the length of time that records must be kept. The final rule requires that identifying information be kept for five years after the date the account is closed (or for credit card accounts, five years after the account is closed or becomes dormant). All other records may be kept for five years after the account is opened.

Third, disclosure burden was reduced by providing sample language that, if appropriate and properly provided, will be deemed adequate notice to a bank's customer. Disclosure burden also was reduced by clarifying the term ''adequate notice.''

Treasury and the Agencies believe that little additional burden is imposed as a result of the recordkeeping requirements outlined in section 103.121(b)(3), because the type of recordkeeping required by the final rule is a usual and customary business practice. In addition, banks already must keep similar records to comply with existing regulations in 31 CFR part 103 (*see, e.g.*, 31 CFR 103.34, requiring certain records for each deposit or share account opened).

Treasury and the Agencies believe that nominal burden is associated with the disclosure requirement outlined in § 103.121(b)(5). This section contains a sample notice that if appropriate and

[41] This definition includes banks, thrifts, and credit unions.

[42] The proposed rule stated that the identity of an existing customer would not need to be verified if the bank (1) had previously verified the customer's identity in accordance with procedures consistent with the proposed rule, and (2) continues to have a reasonable belief that it knows the true identity of the customer.

provided in accordance with the final rule, will be deemed adequate notice. In addition, it continues to permit banks to choose among a variety of low-cost methods of providing adequate notice and to select the least burdensome method, given the circumstances under which customers seek to open new accounts.

Treasury and the Agencies also believe that nominal burden is associated with the new recordkeeping requirement in § 103.121(b)(6). This section permits a bank to rely on another financial institution to perform some or all its CIP under certain conditions, including the condition that the financial institution enter into a contract with the bank providing that it will certify annually to the bank that it (1) has implemented its anti-money laundering program and (2) will perform (or its agent will perform) the specified requirements of the bank's CIP. Not all banks will choose to rely on a third party. For those that do, the minimal burden of retaining the certification described above should allow them to reduce net burden under the rule by such reliance.

Burden Estimates

Treasury and the Agencies have reconsidered the burden estimates published in the proposed rule, given the comments stating that the burdens associated with the paperwork collections were underestimated. Having done so, and considering the reduction in burden taken in this final rule, Treasury and the Agencies have adjusted their estimates of the paperwork burden of this rule. The burden estimates that follow are estimates of the incremental burden imposed upon banks by this final rule, recognizing that some of the requirements in this rule are a usual and customary practice in the banking industry, or duplicate other regulatory requirements.

The potential respondents are national banks and Federal branches and agencies (OCC financial institutions); state member banks and branches and agencies of foreign banks (Board financial institutions); insured state nonmember banks (FDIC financial institutions); savings associations (OTS financial institutions); Federally insured credit unions (NCUA financial institutions); and certain non-Federally regulated credit unions, private banks, and trust companies (FinCEN institutions).

Estimated number of respondents:
OCC: 2207.
Board: 1240.
FDIC: 5,500.
OTS: 962.
NCUA: 9,688.
FinCEN: 2,460.

Estimated average annual recordkeeping burden per respondent: 10 hours.

Estimated average annual disclosure burden per respondent: 1 hour.

Estimated total annual recordkeeping and disclosure burden: 242,627 hours.

Treasury and the Agencies invite comment on the accuracy of the burden estimates and invite suggestions on how to further reduce these burdens. Comments should be sent (preferably by fax (202–395–6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506–0026), Washington, DC 20503 (or by the Internet to *jlackeyj@omb.eop.gov*), with a copy to FinCEN by mail or the Internet at the addresses previously specified.

Executive Order 12866

Treasury, the OCC, and OTS have determined that the final rule is not a ''significant regulatory action'' under Executive Order 12866 for the following reasons.

The rule follows closely the requirements of section 326 of the Act. Moreover, Treasury, the OCC, and OTS believe that national banks and savings associations already have procedures in place that fulfill most of the requirements of the final rule because the procedures are a matter of good business practice. In addition, national banks and savings associations already are required to have BSA compliance programs that address many of the requirements detailed in this final rule.

At the proposed rule stage, Treasury, the OCC, and OTS invited national banks, the thrift industry, and the public to provide any cost estimates and related data that they think would be useful in evaluating the overall costs of the rule. Most of the cost estimates provided by commenters related to the requirements in the proposed rule that banks verify the identity of signatories on accounts, keep copies of documents used to verify a customer's identity, and retain identity verification records for five years after an account is closed. As described in the preamble, the final rule eliminates signatories from the definition of ''customer,'' and no longer requires a bank to keep copies of documents used to verify a customer's identity. The final rule also reduces the universe of records that must be kept for five years after an account is closed. Treasury, the OCC and the OTS have taken other steps that significantly reduce the scope of the rule and the burden of the rule. These burden-reducing measures are described in the Paperwork Reduction Act discussion and Regulatory Flexibility Act discussion, above.[43]

List of Subjects

12 CFR Part 21

Crime, Currency, National banks, Reporting and recordkeeping requirements, Security measures.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Investments, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 211

Exports, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements.

12 CFR Part 326

Banks, banking, Currency, Insured nonmember banks, Reporting and recordkeeping requirements, Security measures.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments, Reporting and Recordkeeping requirements, Savings associations, Securities, Surety bonds.

12 CFR Part 748

Credit unions, Crime, and Security measures.

31 CFR Part 103

Administrative practice and procedure, Authority delegations (Government agencies), Banks, banking, Brokers, Currency, Foreign banking, Foreign currencies, Gambling, Investigations, Law enforcement, Penalties, Reporting and recordkeeping requirements, Securities.

Department of the Treasury

31 CFR Chapter I

Authority and Issuance

■ For the reasons set forth in the preamble, part 103 of title 31 of the Code of Federal Regulations is amended as follows:

[43] For these same reasons, and consistent with section 201 of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4), Treasury, the OTS and the OCC have also determined that this final rule will not result in expenditures by State, local, and tribal governments in the aggregate, or by the private sector of $100 million or more in any one year, and therefore the rule is not subject to the requirements of section 202 of that Act.

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

■ 1. The authority citation for part 103 is revised to read as follows:

Authority: 12 U.S.C. 1829b and 1951–1959; 31 U.S.C. 5311–5314 and 5316–5332; title III, secs. 312, 313, 314, 319, 326, 352, Pub L. 107–56, 115 Stat. 307.

§ 103.11 [Amended]

■ 2. Section 103.11(j) is amended by removing ''paragraph (q)'' and adding ''paragraph (hh)'' in its place.

§ 103.34 [Amended]

■ 3. Section 103.34 is amended as follows:

■ a. By amending the first sentence of paragraph (a)(1) to add the words ''and before October 1, 2003'' after the words ''May 31, 1978'' and after the words ''June 30, 1972'';

■ b. By amending paragraph (b)(11) to add the words ''as determined under section 6109 of the Internal Revenue Code of 1986'' after the words ''taxpayer identification number;'' and

■ c. By amending paragraph (b)(12) to add the words ''as determined under section 6109 of the Internal Revenue Code of 1986'' after the words ''taxpayer identification number.''

■ 2. Subpart I of part 103 is amended by adding new § 103.121 to read as follows:

§ 103.121 Customer Identification Programs for banks, savings associations, credit unions, and certain non-Federally regulated banks.

(a) *Definitions.* For purposes of this section:

(1)(i) *Account* means a formal banking relationship established to provide or engage in services, dealings, or other financial transactions including a deposit account, a transaction or asset account, a credit account, or other extension of credit. *Account* also includes a relationship established to provide a safety deposit box or other safekeeping services, or cash management, custodian, and trust services.

(ii) *Account* does not include:

(A) A product or service where a formal banking relationship is not established with a person, such as check-cashing, wire transfer, or sale of a check or money order;

(B) An account that the bank acquires through an acquisition, merger, purchase of assets, or assumption of liabilities; or

(C) An account opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974.

(2) *Bank* means:

(i) A bank, as that term is defined in § 103.11(c), that is subject to regulation by a Federal functional regulator; and

(ii) A credit union, private bank, and trust company, as set forth in § 103.11(c), that does not have a Federal functional regulator.

(3)(i) *Customer* means:

(A) A person that opens a new account; and

(B) An individual who opens a new account for:

(*1*) An individual who lacks legal capacity, such as a minor; or

(*2*) An entity that is not a legal person, such as a civic club.

(ii) *Customer* does not include:

(A) A financial institution regulated by a Federal functional regulator or a bank regulated by a state bank regulator;

(B) A person described in § 103.22(d)(2)(ii) through (iv); or

(C) A person that has an existing account with the bank, provided that the bank has a reasonable belief that it knows the true identity of the person.

(4) *Federal functional regulator* is defined at § 103.120(a)(2).

(5) *Financial institution* is defined at 31 U.S.C. 5312(a)(2) and (c)(1).

(6) *Taxpayer identification number* is defined by section 6109 of the Internal Revenue Code of 1986 (26 U.S.C. 6109) and the Internal Revenue Service regulations implementing that section (*e.g.*, social security number or employer identification number).

(7) *U.S. person* means:

(i) A United States citizen; or

(ii) A person other than an individual (such as a corporation, partnership, or trust), that is established or organized under the laws of a State or the United States.

(8) *Non-U.S. person* means a person that is not a *U.S. person.*

(b) *Customer Identification Program: minimum requirements.*

(1) *In general.* A bank must implement a written Customer Identification Program (CIP) appropriate for its size and type of business that, at a minimum, includes each of the requirements of paragraphs (b)(1) through (5) of this section. If a bank is required to have an anti-money laundering compliance program under the regulations implementing 31 U.S.C. 5318(h), 12 U.S.C. 1818(s), or 12 U.S.C. 1786(q)(1), then the CIP must be a part of the anti-money laundering compliance program. Until such time as credit unions, private banks, and trust companies without a Federal functional regulator are subject to such a program, their CIPs must be approved by their boards of directors.

(2) *Identity verification procedures.* The CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The procedures must enable the bank to form a reasonable belief that it knows the true identity of each customer. These procedures must be based on the bank's assessment of the relevant risks, including those presented by the various types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, the various types of identifying information available, and the bank's size, location, and customer base. At a minimum, these procedures must contain the elements described in this paragraph (b)(2).

(i) *Customer information required.* (A) *In general.* The CIP must contain procedures for opening an account that specify the identifying information that will be obtained from each customer. Except as permitted by paragraphs (b)(2)(i)(B) and (C) of this section, the bank must obtain, at a minimum, the following information from the customer prior to opening an account:

(*1*) Name;

(*2*) Date of birth, for an individual;

(*3*) Address, which shall be:

(*i*) For an individual, a residential or business street address;

(*ii*) For an individual who does not have a residential or business street address, an Army Post Office (APO) or Fleet Post Office (FPO) box number, or the residential or business street address of next of kin or of another contact individual; or

(*iii*) For a person other than an individual (such as a corporation, partnership, or trust), a principal place of business, local office, or other physical location; and

(*4*) Identification number, which shall be:

(*i*) For a U.S. person, a taxpayer identification number; or

(*ii*) For a non-U.S. person, one or more of the following: a taxpayer identification number; passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

Note to paragraph (b)(2)(i)(A)(*4*)(*ii*): When opening an account for a foreign business or enterprise that does not have an identification number, the bank must request alternative government-issued documentation certifying the existence of the business or enterprise.

(B) *Exception for persons applying for a taxpayer identification number.*

Instead of obtaining a taxpayer identification number from a customer prior to opening the account, the CIP may include procedures for opening an account for a customer that has applied for, but has not received, a taxpayer identification number. In this case, the CIP must include procedures to confirm that the application was filed before the customer opens the account and to obtain the taxpayer identification number within a reasonable period of time after the account is opened.

(C) *Credit card accounts.* In connection with a customer who opens a credit card account, a bank may obtain the identifying information about a customer required under paragraph (b)(2)(i)(A) by acquiring it from a third-party source prior to extending credit to the customer.

(ii) *Customer verification.* The CIP must contain procedures for verifying the identity of the customer, using information obtained in accordance with paragraph (b)(2)(i) of this section, within a reasonable time after the account is opened. The procedures must describe when the bank will use documents, non-documentary methods, or a combination of both methods as described in this paragraph (b)(2)(ii).

(A) *Verification through documents.* For a bank relying on documents, the CIP must contain procedures that set forth the documents that the bank will use. These documents may include:

(*1*) For an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and

(*2*) For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.

(B) *Verification through non-documentary methods.* For a bank relying on non-documentary methods, the CIP must contain procedures that describe the non-documentary methods the bank will use.

(*1*) These methods may include contacting a customer; independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; and obtaining a financial statement.

(*2*) The bank's non-documentary procedures must address situations where an individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard; the bank is not familiar with the documents presented; the account is opened without obtaining documents; the customer opens the account without appearing in person at the bank; and where the bank is otherwise presented with circumstances that increase the risk that the bank will be unable to verify the true identity of a customer through documents.

(C) *Additional verification for certain customers.* The CIP must address situations where, based on the bank's risk assessment of a new account opened by a customer that is not an individual, the bank will obtain information about individuals with authority or control over such account, including signatories, in order to verify the customer's identity. This verification method applies only when the bank cannot verify the customer's true identity using the verification methods described in paragraphs (b)(2)(ii)(A) and (B) of this section.

(iii) *Lack of verification.* The CIP must include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of a customer. These procedures should describe:

(A) When the bank should not open an account;

(B) The terms under which a customer may use an account while the bank attempts to verify the customer's identity;

(C) When the bank should close an account, after attempts to verify a customer's identity have failed; and

(D) When the bank should file a Suspicious Activity Report in accordance with applicable law and regulation.

(3) *Recordkeeping.* The CIP must include procedures for making and maintaining a record of all information obtained under the procedures implementing paragraph (b) of this section.

(i) *Required records.* At a minimum, the record must include:

(A) All identifying information about a customer obtained under paragraph (b)(2)(i) of this section;

(B) A description of any document that was relied on under paragraph (b)(2)(ii)(A) of this section noting the type of document, any identification number contained in the document, the place of issuance and, if any, the date of issuance and expiration date;

(C) A description of the methods and the results of any measures undertaken to verify the identity of the customer under paragraph (b)(2)(ii)(B) or (C) of this section; and

(D) A description of the resolution of any substantive discrepancy discovered when verifying the identifying information obtained.

(ii) *Retention of records.* The bank must retain the information in paragraph (b)(3)(i)(A) of this section for five years after the date the account is closed or, in the case of credit card accounts, five years after the account is closed or becomes dormant. The bank must retain the information in paragraphs (b)(3)(i)(B), (C), and (D) of this section for five years after the record is made.

(4) *Comparison with government lists.* The CIP must include procedures for determining whether the customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. The procedures must require the bank to make such a determination within a reasonable period of time after the account is opened, or earlier, if required by another Federal law or regulation or Federal directive issued in connection with the applicable list. The procedures must also require the bank to follow all Federal directives issued in connection with such lists.

(5)(i) *Customer notice.* The CIP must include procedures for providing bank customers with adequate notice that the bank is requesting information to verify their identities.

(ii) *Adequate notice.* Notice is adequate if the bank generally describes the identification requirements of this section and provides the notice in a manner reasonably designed to ensure that a customer is able to view the notice, or is otherwise given notice, before opening an account. For example, depending upon the manner in which the account is opened, a bank may post a notice in the lobby or on its website, include the notice on its account applications, or use any other form of written or oral notice.

(iii) *Sample notice.* If appropriate, a bank may use the following sample language to provide notice to its customers:

IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name,

address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

(6) *Reliance on another financial institution.* The CIP may include procedures specifying when a bank will rely on the performance by another financial institution (including an affiliate) of any procedures of the bank's CIP, with respect to any customer of the bank that is opening, or has opened, an account or has established a similar formal banking or business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions, provided that:

(i) Such reliance is reasonable under the circumstances;

(ii) The other financial institution is subject to a rule implementing 31 U.S.C. 5318(h) and is regulated by a Federal functional regulator; and

(iii) The other financial institution enters into a contract requiring it to certify annually to the bank that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) the specified requirements of the bank's CIP.

(c) *Exemptions.* The appropriate Federal functional regulator, with the concurrence of the Secretary, may, by order or regulation, exempt any bank or type of account from the requirements of this section. The Federal functional regulator and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act and with safe and sound banking, and may consider other appropriate factors. The Secretary will make these determinations for any bank or type of account that is not subject to the authority of a Federal functional regulator.

(d) *Other requirements unaffected.* Nothing in this section relieves a bank of its obligation to comply with any other provision in this part, including provisions concerning information that must be obtained, verified, or maintained in connection with any account or transaction.

Dated: April 28, 2003.

James F. Sloan,

Director, Financial Crimes Enforcement Network.

Dated: April 17, 2003.

In concurrence:

John D. Hawke, Jr.,

Comptroller of the Currency.

In concurrence:

By order of the Board of Governors of the Federal Reserve System, April 21, 2003.

Jennifer J. Johnson,

Secretary of the Board.

In concurrence:

By order of the Board of Directors of the Federal Deposit Insurance Corporation this 16th day of April, 2003.

Valerie J. Best,

Assistant Executive Secretary.

In concurrence:

Dated: April 9, 2003.

James E. Gilleran,

Director, Office of Thrift Supervision.

In concurrence:

Dated: April 7, 2003.

Becky Baker,

Secretary of the Board, National Credit Union Administration.

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

■ For the reasons set out in the preamble, the OCC amends chapter I of title 12 of the Code of Federal Regulations as set forth below:

PART 21—MINIMUM SECURITY DEVICES AND PROCEDURES, REPORTS OF SUSPICIOUS ACTIVITIES, AND BANK SECRECY ACT COMPLIANCE PROGRAM

Subpart C—Procedures for Monitoring Bank Secrecy Act Compliance

■ 1. The authority citation for part 21, subpart C, continues to read as follows:

Authority: 12 U.S.C. 93a, 1818, 1881–1884 and 3401–3422; 31 U.S.C. 5318.

■ 2. In § 21.21:
■ A. Revise the section heading; and
■ B. Revise § 21.21(b) to read as follows:

§ 21.21 Procedures for monitoring Bank Secrecy Act (BSA) compliance.

* * * * *

(b) *Establishment of a BSA compliance program.* (1) *Program requirement.* Each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program must be written, approved by the bank's board of directors, and reflected in the minutes of the bank.

(2) *Customer identification program.* Each bank is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the OCC and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.

* * * * *

Dated: April 17, 2003.

John D. Hawke, Jr.,

Comptroller of the Currency.

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

■ For the reasons set out in the preamble, the Board of Governors of the Federal Reserve System amends 12 CFR Chapter II as follows:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

■ 1. The authority citation for part 208 continues to read as follows:

Authority: 12 U.S.C. 24, 24a, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p–1, 1831r–1, 1831w, 1831x, 1835a, 1843(l), 1882, 2901–2907, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

■ 2. Revise § 208.63(b) to read as follows:

§ 208.63 Procedures for monitoring Bank Secrecy Act compliance.

* * * * *

(b) *Establishment of BSA compliance program.* (1) *Program requirement.* Each bank shall develop and provide for the continued administration of a program reasonably designed to ensure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code, the Bank Secrecy Act, and the implementing regulations promulgated thereunder by the Department of the Treasury at 31 CFR part 103. The compliance program shall be reduced to writing, approved by the board of directors, and noted in the minutes.

(2) *Customer identification program.* Each bank is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the Board and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be

implemented as part of the BSA compliance program required under this section.

* * * * *

PART 211—INTERNATIONAL BANKING OPERATIONS (REGULATION K)

■ 1. The authority citation for part 211 is revised to read as follows:

Authority: 12 U.S.C. 221 *et seq.,* 1818, 1835a, 1841 *et seq.,* 3101 *et seq.,* and 3901 *et seq.;* 15 U.S.C. 6801 and 6805; 31 U.S.C. 5318.

■ 2. In § 211.5, add new paragraph (m) to read as follows:

§ 211.5 Edge and agreement corporations.

* * * * *

(m) *Procedures for monitoring Bank Secrecy Act compliance.*

(1) [Reserved]

(2) *Customer identification program.* Each Edge or agreement corporation is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the Board and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program.

■ 3. In § 211.24, add new paragraph (j) to read as follows:

§ 211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.

* * * * *

(j) *Procedures for monitoring Bank Secrecy Act compliance.*

(1) [Reserved]

(2) *Customer identification program.* Except for a federal branch or a federal agency or a state branch that is insured by the FDIC, a branch, agency, or representative office of a foreign bank operating in the United States is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the Board and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program.

By order of the Board of Governors of the Federal Reserve System, April 21, 2003.

Jennifer J. Johnson,

Secretary of the Board.

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

■ For the reasons set out in the preamble, the FDIC amends title 12, chapter III of the Code of Federal Regulations, as set forth below:

PART 326—Minimum Security Devices and Procedures and Bank Secrecy Act Compliance

■ 1. The authority citation for part 326 is revised to read as follows:

Authority: 12 U.S.C. 1813, 1815, 1817, 1818, 1819 (Tenth), 1881–1883; 31 U.S.C. 5311–5314 and 5316–5332.2.

■ 2. Revise § 326.8(b) to read as follows:

§ 326.8 Bank Secrecy Act compliance.

* * * * *

(b) *Compliance procedures.* (1) *Program requirement.* Each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program shall be written, approved by the bank's board of directors, and noted in the minutes.

(2) *Customer identification program.* Each bank is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the FDIC and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the Bank Secrecy Act compliance program required under this section.

* * * * *

By order of the Board of Directors of the Federal Deposit Insurance Corporation this 16th day of April, 2003.

Valerie J. Best,

Assistant Executive Secretary.

Office of Thrift Supervision

12 CFR Chapter V

Authority and Issuance

■ For the reasons set out in the preamble, OTS amends title 12, chapter V of the Code of Federal Regulations, as set forth below:

PART 563—SAVINGS ASSOCIATIONS—OPERATIONS

■ 1. The authority citation for part 563 is revised to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1820, 1828, 1831o, 3806; 31 U.S.C. 5318; 42 U.S.C. 4106.

■ 2. In § 563.177:

■ A. Revise the section heading; and

■ B. Revise paragraph (b) to read as follows:

§ 563.177 Procedures for monitoring Bank Secrecy Act (BSA) compliance.

* * * * *

(b) *Establishment of a BSA compliance program.* (1) *Program requirement.* Each savings association shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program must be written, approved by the savings association's board of directors, and reflected in the minutes of the savings association.

(2) *Customer identification program.* Each savings association is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the OTS and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.

* * * * *

Dated: April 9, 2003.

James E. Gilleran,

Director, Office of Thrift Supervision.

National Credit Union Administration

12 CFR Chapter VII

Authority and Issuance

■ For the reasons set out in the preamble, NCUA amends title 12, chapter VII of the Code of Federal Regulations, as set forth below:

PART 748—SECURITY PROGRAM, REPORT OF CRIME AND CATASTROPHIC ACT AND BANK SECRECY ACT COMPLIANCE

■ 1. The authority citation for part 748 is revised to read as follows:

Authority: 12 U.S.C. 1766(a), 1786(q); 15 U.S.C. 6801 and 6805(b); 31 U.S.C. 5311 and 5318.

■ 2. In § 748.2:

■ A. Revise the section heading; and

■ B. Revise paragraph (b) to read as follows:

§ 748.2 Procedures for monitoring Bank Secrecy Act (BSA) compliance.

* * * * *

(b) *Establishment of a BSA compliance program.* (1) *Program requirement.* Each federally-insured credit union shall develop and provide for the continued administration of a

program reasonably designed to assure and monitor compliance with the recordkeeping and recording requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program must be written, approved by the credit union's board of directors, and reflected in the minutes of the credit union.

(2) *Customer identification program.* Each federally-insured credit union is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the NCUA and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.

* * * * *

Dated: April 7, 2003.

Becky Baker,

Secretary of the Board, National Credit Union Administration.

[FR Doc. 03–11019 Filed 5–8–03; 8:45 am]

BILLING CODE 4810–02–P; 6720–01–P; 6210–01–P; 7537–01–P; 4810–33–P; 6714–01–P

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 740

Accuracy of Advertising and Notice of Insured Status

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is revising its rule governing advertising and the requirements for use of the official sign and official advertising statement regarding insured status. The revision modernizes and streamlines the rule for ease of reference and addresses the growing use of the Internet for member transactions and the use of trade names in advertising.

EFFECTIVE DATE: This rule is effective July 1, 2003.

FOR FURTHER INFORMATION CONTACT: Dianne M. Salva, Staff Attorney, Division of Operations, Office of General Counsel, at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia, 22314, or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

I. Background

On September 19, 2002, the NCUA Board (the Board) approved the publication of a proposal to update and streamline Part 740, NCUA's regulation requiring accuracy and honesty in insured credit union (CU) advertising and governing a CU's use of the official sign and official advertising statement to inform members of federal share insurance coverage. 67 FR 60604 (September 26, 2002).

The Official Sign: The regulation requires CUs to display the official sign, which sets out in large type ''NCUA'' and in smaller type states, ''Your savings federally insured to $100,000,'' at each teller station or window where insured account funds or deposits are normally received. The purpose of the rule is to ensure that, at the time they deposit funds or transact business with an insured CU, members are informed of the fact that federal share insurance applies to their accounts.

The Official Advertising Statement: The regulation, although containing various exemptions, also requires a CU to include the official advertising statement in any advertising including marketing materials in print, radio or television. The official advertising statement must state in substance, ''This credit union is federally insured by the National Credit Union Administration.'' Alternatively, the CU may use the short form advertising statement, ''Federally insured by NCUA'' with a reproduction of the official sign described above.

The proposal clarified the rule's application to Internet advertisements and member transactions on CU Web sites. It also incorporated legal interpretations permitting CUs to use trade or other names in advertisements and made other minor changes, including rewording it in a plain English style and placing the provisions regarding advertising excess insurance in a separate subsection.

II. Comments

NCUA received fourteen comments from the public. Seven commenters expressed their support for the amendment permitting the use of trade names in advertising. The proposal stated that, while CUs may use trade or other names in advertising, they must use their official charter name in all official or legal documents. The proposal did not include share certificates among the official or legal documents in which CUs must identify themselves with their official charter name. This was an inadvertent omission that has been corrected in the final rule. The purpose in excluding the use of trade names in official or legal documents is to ensure that members do not misinterpret the level of share insurance available to them. The Board agrees with a commenter who suggested that if a CU used the full charter name the first time it appears in a legal document and an acronym later in the same document members would be sufficiently informed about the identity of the CU and the availability of share insurance.

Thirteen commenters supported the requirement to use the official sign and official advertising statement on Internet Web sites, with five stating that the revised rule offered CUs flexibility and would not impose a significant burden. One commenter emphasized that the benefit to consumers would far outweigh any cost incurred by the credit union. Two state leagues stated that most of their credit unions were already in compliance.

Six commenters, while supportive of the proposal, suggested that NCUA permit CUs to alter the official sign's color and font sizes to ensure it is legible and visually prominent on an Internet screen. Although the proposed rule did not suggest any changes to the color or font size of the official sign, the Board agrees that the official sign must be legible to fulfill the purpose of the rule. The Board believes that additional flexibility may be helpful given the size constraints of an Internet screen and the rule's requirement that the sign appear on the same page where other information will also appear. For that reason, the Board is including in the final rule a provision that CUs may vary the font size of the text within the official sign to ensure the text is legible. The Board also recognizes that CUs may find the requirement in the current rule that the official sign appear in blue with white lettering to be unduly restrictive. Many CUs devote significant resources to the design and aesthetics of their Web sites, with a focus on attracting both new and existing members to view the information and transact business. Some commenters were concerned that the traditional colors might be less visible or contrast with CU Web site designs. The Board is most concerned that the message of the official sign is conveyed clearly. The Board also does not want CUs to be unnecessarily restricted in the color or design of their Web sites by the need to display the official sign in only the traditional colors of blue and white. In the past, NCUA has been asked to consider similar flexibility in the color of the official signs CUs display at teller windows or stations at ''brick and mortar'' locations. The Board sees no reason why CUs should not use the colors of their choosing on the official signs they display both on CU Web sites and in their lobbies. For these reasons, the Board has eliminated from the final rule the requirement that the official sign , have a blue background with white lettering. NCUA will continue to supply CUs with official signs, but will produce them only in the traditional blue and white.

Six commenters also stated that it is unnecessary to require the official sign or advertising statement on Internet pages other than the credit union main page. As an alternative two commenters suggest that the rule only require the official sign on the main page and the log-on screen where members identify themselves in order to conduct transactions on-line, or a membership application page or pages advertising deposit-related products. The Board agrees with these suggestions. All CU Internet sites that permit members to conduct transactions require members to identify themselves on a log-on screen. Displaying the official sign there will provide adequate notice of federal share insurance to the member. Further, displaying the official sign or advertising statement on the page where a viewer can apply for membership or see an advertisement for an insured deposit or share-related product will ensure that the message about federal

share insurance is available when it is most relevant.

One commenter suggested that CUs that currently do not display an official sign or advertising statement on their Web sites may need additional time to comply with the proposed changes. The Board wishes to permit CUs ample opportunity to incorporate the official sign and advertising statement into their Web sites, so it is adopting an effective date 60 days following publication of the final rule.

The final rule is identical to the proposed rule with the exception of minor editorial changes, the addition of share certificates among the official or legal documents in which CUs must identify themselves with their official charter name, the provision permitting CUs to use alternative font sizes in the official sign displayed on their Internet Web sites and the elimination of the color requirement for the official sign.

III. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under $1 million in assets). The final amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final regulation does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The executive order states that: ''National action limiting the policymaking discretion of the states shall be taken only where there is constitutional and statutory authority for the action and the national activity is appropriate in light of the presence of a problem of national significance.'' This rule will apply to both federal and state credit unions. It does not significantly change the current regulatory framework. It will not have a substantial direct effect on states, the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the rule does not constitute a policy that has federalism implications for purposes of this executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. The regulatory change is understandable and imposes minimal regulatory burden.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has found that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects 12 CFR Part 740

Advertisements, Credit unions.

By the National Credit Union Administration Board on April 24,2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 741

Requirements for Insurance

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is adopting a final rule that establishes the requirements for federally insured credit unions to branch outside the United States. The final rule requires a credit union to develop a business plan and receive foreign government and NCUA approval before establishing a branch outside the United States.

DATES: This regulation is effective July 1, 2003.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Senior Staff Attorney, Division of Operations, Office of General Counsel, telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION: On September 7, 2000, the Board issued an advance notice of proposed rulemaking (ANPR). (65 FR 55464, September 14, 2000). The comment period for the ANPR ended on November 14, 2000. The key issues raised in the ANPR included: NCUA Board policy considerations, legal issues, supervision and examination considerations, options for insuring foreign branches of state-chartered credit unions, and options for restricting insurance coverage for state-chartered credit unions operating foreign branches.

On September 19, 2002, after carefully considering the comments and discussing the issue with state regulators, the NCUA Board issued a proposed rule that requires a credit union to obtain host country approval and develop a comprehensive business plan in order to obtain NCUA approval to establish a branch in a foreign country. (67 FR 60607, September 26, 2002). A federally insured, state-chartered credit union would also have to obtain state regulatory approval.

Comments

Twenty-one comments were received. Comments were received from eight federal credit unions, three state-chartered credit unions, four state leagues, three credit union trade associations, two attorneys, and one bank trade association. In general, most commenters support the proposal. Six commenters applauded the Board's decision to include federal credit unions in this proposal.

Three commenters opposed the proposal. Two of these commenters believe foreign branches inherently carry more risk than domestic branches. They believe that although the proposal minimizes risk, it is not eliminated. They suggest that foreign branches would be prime targets for money laundering. Finally, they believe that foreign branches will be costly to the National Credit Union Share Insurance Fund (NCUSIF) and, thus, federally insured credit unions.

Discussion

The NCUA Board proposed a three-step process to branch outside the United States. Most commenters supported the three-step process but suggested some changes to the proposal.

First, under the proposal, a credit union must receive written approval from the host country to establish the branch that explicitly recognizes NCUA's authority to examine and take any enforcement action with regard to that branch office, including conservatorship and liquidation actions. If a credit union is state-chartered, it must also obtain written approval from its state supervisory agency and submit the approval with the application.

Three commenters did not support this first requirement. One commenter believes it may be difficult for a credit union to obtain host country approval recognizing NCUA's authority. All three commenters believe this is an issue that should be worked on between NCUA and the various host countries.

One commenter requested that the rule language on host country approval should read ''that explicitly recognizes NCUA's authority, in consultation with the host country, to examine and take mutually agreeable enforcement action with regard to that branch office.'' One commenter stated that it recognizes that NCUA is not seeking exclusive authority over the branch and anticipates the host country also will be in a position to exercise regulatory authority under its own regulatory framework and believes this should be stated in the rule. Another commenter believes NCUA should regulate the foreign branches of credit unions jointly with the foreign banking regulators. One commenter believes an enforcement conflict might occur if a host country requires the branch to have host country deposit insurance.

The NCUA Board believes, for safety and soundness reasons, it is critical for a credit union to obtain host country approval and recognition of NCUA's authority. To require less would pose an undue risk to the NCUSIF. The Board is not requiring exclusive authority over a foreign branch and recognizes that a host country also will have some regulatory authority over a foreign branch office. NCUA, however, must have the right to examine a foreign branch and take any necessary enforcement actions. Finally, NCUA does not have the legal authority to engage in discussions or enter into agreements with foreign governments on the establishment of branches. The Board believes the proper party to obtain host country approval is the credit union seeking NCUA's approval. Credit unions wishing to engage in this activity also might want to obtain the assistance of their trade associations and state leagues in communicating with foreign governments.

Second, under the proposal, a credit union must develop a detailed business plan that addresses the following: (1) Analysis of market conditions in the area where the branch is to be established; (2) the credit union's plan for addressing foreign currency risk; (3) operating facilities, including office space, equipment and supplies; (4) safeguarding of assets, insurance coverage, and records preservation; (5) written policies regarding the branch (shares, lending, capital, charge-offs, collections); (6) the field of membership or portion of the field of membership to be served through the foreign branch and the financial needs of the members to be served and services and products to be provided; (7) detailed *pro forma* financial statements for branch operations (balance sheet and income and expense projections) for the first and second year, including assumptions; (8) internal controls, including cash disbursal procedures for shares and loans at the branch; (9) accounting procedures used to identify branch activity and performance; and (10) foreign income taxation.

Four commenters agreed with the business plan requirement. Four commenters stated that the services offered through the foreign branch should be limited to those approved by NCUA. Two commenters that believe all assets of a foreign branch should be required to be denominated in U.S. dollars stated that, if all the assets of the foreign branch were U.S. dollar denominated, there would be no need to address currency risk in the business plan. The Board is not mandating that all assets be denominated in U.S. dollars to provide flexibility in establishing a branch; however, as discussed below, if a credit union wants federal share insurance for the deposits in a foreign branch, then assets must be denominated in U.S. dollars.

One commenter stated the business plan requirement should only be for federal credit unions. Four commenters believe the business plan requirements are excessive and suggested that it be streamlined. Another commenter also believes the business plan is excessive and should only consider the overall strength of the credit union (CAMEL 1 or CAMEL 2) and the competency of the credit union's management. Two commenters stated that field of membership should not be addressed in the business plan. One commenter would delete the requirement for a market analysis. A few commenters suggested that regional directors should be encouraged to consider relevant employment laws of the host country and whether an applicant credit union is fully aware of the impact of such laws.

The NCUA Board believes that the business plan requirements are prudent and the minimum a credit union should consider before establishing a foreign branch. The Board agrees that knowledge of foreign employment laws is also an important component in determining whether to establish a foreign branch and has added that to the business plan. The Board also clarified in the final rule that credit unions need to address the issue of bond coverage in the business plan.

Third, under the proposal, a state-chartered credit union must submit documentation showing state regulator approval. One commenter supported this requirement. Four commenters believe that NCUA should not be involved in the approval process for state-chartered credit unions. Three of these commenters believe NCUA should not approve a branch, but only approve insurance coverage for a branch. They believe that, once NCUA has approved a country for federal insurance, then no further NCUA approval should be necessary for federally insured state-chartered credit unions.

A foreign branch poses significantly greater risk to the NCUSIF than a domestic branch. Although this rule minimizes risk, it certainly does not eliminate it. Therefore, whether a credit union is state-chartered or federally-chartered, the risk to the NCUSIF is the same, and NCUA must have the final authority to approve or disapprove a foreign branch.

Under the proposal, the regional director has 60 days to approve the application, but may extend the time period for good cause. The regional director may revoke approval of a foreign branch office for failure to follow the business plan in any material respect or for substantive and documented safety and soundness reasons. If the credit union wants to make a material deviation from its previously approved business plan, it must submit a new business plan for approval. If the regional director revokes the approval, a credit union has six months from the date of the revocation letter to terminate the operations of the branch. The credit union can appeal this revocation directly to the NCUA Board. One commenter fully supported the revocation process.

Four commenters requested that the central office, not the regional directors, process the approval and revocation of foreign branches because they believe central office staff will be more knowledgeable about the issues. Two commenters request that NCUA state that the six-month revocation period starts to run only after the regional director decision or after a decision on an appeal to the NCUA Board has been rendered, whichever is later.

The NCUA Board is retaining in the final rule the revocation process as proposed. It is anticipated that regional offices will consult with central office staff when they believe it is necessary. The Board is not changing the six-month time frame for the closing of a branch while a decision is under appeal because of safety and soundness considerations. If a credit union files an appeal after receiving a notice of revocation from a regional director, it must continue to plan on closing the branch within six months. Filing an appeal will not toll the running of the six-month period for closure of a foreign branch. The Board believes it will be able to consider appeals of a revocation expeditiously and notes that a credit union that has received a revocation and wishes to appeal to the Board must submit its appeal within 30 days of the revocation letter.

Three commenters believe that the state regulator should have unilateral authority to approve and revoke foreign branch activity. One commenter wondered how coordination with the state regulator would occur in the event the state regulator wishes to revoke approval of the branch office. The NCUA Board wishes to clarify that if a state regulator wishes to revoke approval of a foreign branch, NCUA's concurrence is not necessary. The Board, however, has added a sentence to the rule requiring the state regulator to notify NCUA after it issues a notice of revocation.

The NCUA Board decided not to propose any field of membership restrictions on the foreign branch or capital requirements above those required by NCUA's prompt corrective action rule. 12 CFR part 702. Three commenters agreed with the Board's decision not to propose field of membership restrictions or impose additional capital requirements for credit unions that want to branch in foreign countries. One commenter requested that the final rule address how a credit union can expand its field of membership in the foreign country. A federal credit union can expand its field of membership in the manner set forth in NCUA's Chartering and Field of Membership Manual. A state chartered credit union should look to applicable state law.

The Board clarified in the proposal that a representation office or a liaison office is not a branch office for purposes of this regulation. NCUA's understanding is that such offices do not engage in processing loan applications and do not disburse loans. Rather loan documents are transferred from the liaison office to the credit union's main office in the United States where loan decisions are made and loan disbursals are made in U.S. dollars. Two commenters appreciated and supported this clarification. The Board concurs with the commenter who stated that an ATM is not a branch for purposes of this rule.

On the issue of insurance, the NCUA Board stated that if there are no changes to NCUA's insurance regulation, a federally insured credit union that opens a branch office outside the United States would have its member share accounts at that branch federally insured. The NCUA Board also stated that the credit union's business plan would be required to address the insured status of member accounts and, in any event, accounts would be insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the term of the account agreement, at a U.S. office of the credit union. If the host country requires insurance from its own system, accounts would not be insured by the NCUSIF. The NCUA Board also requested specific comment on the insurance issue.

Ten commenters agreed with NCUA's view on insurance coverage. Two of these commenters believe the proposal mitigates the additional risk to the NCUSIF that accompany foreign branch activity. One commenter believes that insuring accounts in branches that are not located either on military installations or U.S. embassies is entirely inappropriate.

One commenter does not believe the NCUSIF should cover foreign branch deposits unless that is part of an agreement between the two countries' regulatory and insurance authorities.

One commenter stated that NCUA should insure deposits up to the U.S. limit except in those countries where the NCUA has specifically negotiated other arrangements with the foreign government. One commenter believes NCUSIF coverage should be mandatory for accounts opened at the foreign branch of a federally-insured credit union but believes that NCUSIF coverage should only be secondary if the foreign branch also carries foreign share insurance.

The NCUA Board believes that the proposed insurance treatment of foreign branches is reasonable, mitigates risks, and provides credit unions with significant flexibility.

Therefore, to receive NCUA's approval for a foreign branch, a credit union must address in its business plan how accounts will be insured and agree that accounts would be insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the terms of the account agreement, at a U.S. office of the credit union. If the host country requires insurance from its own system, accounts will not be insured by the NCUSIF. To avoid any confusion on this issue the NCUA Board is adding a section (e) to the rule to address insurance treatment at foreign branches.

Miscellaneous

One commenter encouraged the Board to amend Part 703 to allow additional investment tools to hedge currency risk via derivative instruments. Proposed revisions to Part 703 have been issued for comment and the NCUA Board will consider such recommended changes in the context of finalizing that rule. One commenter thought the phrase ''take action'' in § 741.11(a) was ambiguous and should be rephrased. Although the Board did not find the phrase ambiguous, it changed the term to ''approve or deny'' to avoid any confusion.

Four commenters stated that credit unions with foreign branches should pay for any additional cost NCUA or NCUSIF might incur in examining their foreign branches. A few commenters believe that NCUA should mandate that its examiners routinely inspect the foreign branches at the expense of the credit unions with those branches. Two commenters asked for more clarification on how NCUA will carry out its regular examination functions of a credit union branch located in a foreign country. At this time, the NCUA Board is not planning on imposing any additional fees on credit unions with foreign branches and is not planning on any significant changes in the examination process. NCUA will continue to monitor the establishment of foreign branches and will revisit both issues after gaining some experience with this activity.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any final regulation may have on a substantial number of small entities (those under one million dollars in assets). The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. The reason for this determination is that the Board believes it is very unlikely that small credit unions have the financial capability and experience to establish a branch in a foreign country. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The paperwork requirements in § 741.11 have been submitted to the Office of Management and Budget. NCUA will publish the OMB control number as soon as it is issued. Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless NCUA displays a valid OMB number. The control number will be displayed in the table at 12 CFR part 795.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The executive order states that: ''National action limiting the policymaking discretion of the states shall be taken only where there is constitutional and statutory authority for the action and the national activity is appropriate in light of the presence of a problem of national significance.'' The risk of loss to federally insured credit unions and the NCUSIF caused by the establishment of foreign branches is a concern of national scope. The final rule helps assure that proper safeguards are in place to ensure the safety and soundness of federally insured credit unions that establish branches in foreign countries.

The final rule applies to all federally insured credit unions. NCUA believes that the protection of those credit unions, and ultimately the NCUSIF, warrants application of the final rule to all federally insured credit unions. The final rule does not impose additional costs or burdens on the states or affect the states' ability to discharge traditional state government functions. NCUA has determined that this rule may have an occasional direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The potential risk to the NCUSIF without the rule justifies this action.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

List of Subjects in 12 CFR Part 741

Bank deposit insurance, Credit unions.

By the National Credit Union Administration Board on April 24, 2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 703 and 742

Investment and Deposit Activities and Regulatory Flexibility Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its rule regarding the investment activities of Federal Credit Unions (FCUs). The amendments clarify and reformat the rule to make it easier to read and locate information. The amendments expand FCU investment authority to include purchasing equity-linked options for certain purposes and exempt RegFlex eligible FCUs from several investment restrictions. NCUA is also amending the Regulatory Flexibility Program to conform to the revisions to the investment rule.

DATES: The final rule is effective July 3, 2003.

FOR FURTHER INFORMATION CONTACT: Scott Hunt, Senior Investment Officer, Office of Strategic Program Support and Planning (OSPSP) at the above address or telephone (703) 518–6620; Dan Gordon, Senior Investment Officer, OSPSP at the above address or telephone; Kim Iverson, Program Officer, Office of Examination and Insurance, at the above address or telephone (703) 518–6360; or Frank Kressman, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

NCUA identified part 703 of its rules as in need of revision. To that end, NCUA issued an advance notice of proposed rulemaking (ANPR) on October 18, 2001. 66 FR 54168 (October 26, 2001). After considering the comments to the ANPR submitted by 38 commenters, NCUA issued a proposed rule on December 19, 2002. 67 FR 78996 (December 27, 2002). NCUA received 14 comment letters regarding the proposed rule: five from FCUs, one from a State credit union, five from financial services entities, and three from credit union trade organizations. The comments were generally supportive of the proposal.

B. Summary of Comments

1. Broker-dealers and Safekeeping of Investments

Throughout the rulemaking process, NCUA has expressed concern about the purchase of some brokered certificates of deposit (CDs). Deceptive practices or outright fraud on the part of some broker-dealers and safekeepers have caused losses for FCUs. NCUA does not believe, however, that more stringent standards on broker-dealers or safekeepers, such as those contemplated by the ANPR, would prevent losses. NCUA believes continued guidance to FCUs and prudent due diligence by FCUs is the best course of action. Therefore, NCUA is not making any substantive changes to broker-dealer and safekeeping requirements in this regard. The commenters generally supported this position.

The proposed rule permits the use of depository institutions whose broker-dealer activities are regulated by a State regulatory agency. This provides FCUs with greater access to broker-dealers. NCUA also believes additional broker-dealer competition promotes improved service, better execution, and reduced costs. The commenters supported this proposal. The Board adopts this proposed revision in the final rule.

Former § 703.50(c) exempts CD finders from the broker-dealer requirements. It was always NCUA's intent to carry this exemption forward in proposed § 703.8 as indicated in the preamble to the proposed rule. 67 FR 78996, 78996–97 (December 27, 2002). Specifically, if an FCU purchases a CD or share certificate directly from a bank, credit union, or other depository institution that issues the certificate, the FCU will not be bound by the broker-dealer requirements. This exemption was inadvertently omitted in the regulatory language in § 703.8 of the proposed rule through a clerical error. As stated in the proposal's preamble, NCUA indicated it was making no changes to the broker-dealer section of the rule in this regard. Thus, the inclusion of this exemption in the final rule will not change the requirements pertaining to the use of broker-dealers.

To be consistent with the broker-dealer requirements, the proposed rule added a due diligence requirement that calls for an FCU to review a safekeeper's financial condition, in addition to its registration status, and retain the documentation used to approve a safekeeper. NCUA believes these requirements represent prudent, minimum practices that FCUs should follow when evaluating a safekeeper. In addition, the proposed rule permitted State-regulated trust companies to be safekeepers for FCUs. NCUA recognizes these firms can provide a sound alternative for FCUs.

The commenters overwhelmingly concurred with this aspect of the proposed rule. NCUA adopts this proposal in the final rule.

2. Expanded Investment Authorities

The Federal Credit Union Act (Act) enumerates FCU investment powers. 12 U.S.C. 1757(7), (8), and (15). NCUA has adopted regulatory prohibitions against certain investments and investment activities permitted by the Act on the basis of safety and soundness concerns. In revising the rule, NCUA has explored ways to expand FCU investment powers. Generally, those investments currently prohibited by regulation exhibit high risks or are unsuitable for many FCUs, such as stripped mortgage-backed securities or variable rate investments tied to non-domestic interest rates.

As one means of expanding investment powers, the proposed rule permits some FCUs to purchase commercial mortgage related securities (CMRS), subject to certain restrictions. Specifically, the proposed rule limits the purchase of CMRS, which are not otherwise permitted by § 107(7)(E) of the Act, 12 U.S.C. 1757(7)(E), to RegFlex eligible FCUs. 12 CFR part 742. Further, a RegFlex eligible FCU may purchase CMRS if the CMRS: (1) Are rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization; (2) otherwise meet the definitions of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and CMRS as defined in proposed § 703.2; and (3) have an underlying pool of loans containing more than 50 loans with no one loan representing more than 10 percent of the pool. A RegFlex eligible FCU is limited to purchasing CMRS in an aggregate amount of up to 50 percent of its net worth. Most commenters supported NCUA's proposal to permit RegFlex eligible FCUs to purchase CMRS with certain limitations. NCUA adopts this proposal as final.

A few commenters suggested NCUA should adopt additional requirements or restrictions to address sound risk management practices for CMRS. NCUA believes no changes are necessary in this regard, but reminds FCUs that former § 703.30 already requires FCUs to develop investment policies that address credit, liquidity, interest rate, and concentration risks. 12 CFR 703.30. The policy must also stipulate the characteristics of any investments that are suitable for the FCU. These requirements carry over to the final rule. Thus, FCUs that purchase CMRS must develop sound risk management policies and construct limits that represent the FCU board's risk tolerance.

NCUA also proposed to permit FCUs to purchase equity options for the sole

purpose of offering dividends based on the performance of an equity index. This proposal evolved from the experience gained monitoring an investment pilot program. The pilot program enabled NCUA to review the demands and risks associated with such a program before developing a regulation. Commenters agreed that the proposed regulatory language was prudent and would not pose any undue burden on FCUs. NCUA adopts the proposal.

NCUA has determined that other currently prohibited investments should remain prohibited due to the complexity of the instruments or the difficulty in managing their associated risks. However, NCUA encourages FCUs that believe they possess the skills and resources to manage such investments to apply for a pilot program. The commenters generally supported this approach to expanding investment powers. NCUA remains committed to publishing standards for pilot programs that have been approved to facilitate future applications. These guidelines will be available on the NCUA website or by contacting the appropriate NCUA regional office. Additionally, investment pilot program applicants are encouraged to submit alternative proposals for NCUA's consideration.

3. Discretionary Control of Investments and Investment Advisers

Former § 703.40(c)(6) authorizes an FCU to delegate to an outside third party discretionary control over the purchase and sale of investments, up to 100 percent of the FCU's net capital at the time of delegation. 12 CFR 703.40(c)(6). RegFlex eligible FCUs are exempt from this cap. 12 CFR 742.4.

NCUA proposed that FCUs conduct an annual evaluation of the amount of investments under discretionary control. Further, the proposal required an FCU to notify its board of directors and the appropriate regional director if the amount under discretionary control exceeds the cap at the time of the annual evaluation. An FCU must develop a plan to bring itself into compliance with the cap within a reasonable period of time.

Generally, commenters supported this proposal, although a few commenters suggested that NCUA permit all FCUs to exceed the cap, not just RegFlex eligible FCUs. These commenters stated that FCUs not meeting RegFlex eligibility may benefit most from having an investment professional manage an FCU's investments. NCUA has determined not to lift the cap for FCUs ineligible for RegFlex. NCUA notes that an FCU currently not meeting RegFlex eligibility requirements may petition its regional director for a RegFlex designation. The Board adopts the proposed revisions.

Commenters also questioned whether it was reasonable for an FCU board to be required to notify the appropriate regional director of any violation of the cap within five business days of exceeding the cap. NCUA believes this is reasonable. The regulation stipulates that an FCU only notify its regional director within five business days. An FCU is not required to submit a plan to bring it into compliance within this time frame. An FCU must develop a plan within a reasonable period of time after notification. A reasonable period of time will be decided by the regional director after considering an FCU's circumstances, including the materiality of the breach and the risk to the FCU's earnings and capital.

In response to a commenter's question, NCUA clarifies that mutual funds are not included in the calculation of funds under discretionary control.

As part of the background check of an investment advisor, the proposed rule required that an FCU analyze the background of the firm for whom an investment adviser works, in addition to the investment adviser and his or her associated personnel. No commenters objected to this requirement. This proposed change is adopted in the final rule. Several commenters urged NCUA to clarify the meaning of ''associated personnel'' as it is used in proposed § § 703.5 and 703.8. NCUA notes that the proposed rule included a definition for ''associated personnel'' in proposed § 703.2 and it is adopted in the final.

4. Borrowing Repurchase Transaction

Borrowing repurchase transactions, formerly referred to as reverse repurchase transactions, enable an FCU to sell securities under an agreement to repurchase in order to borrow funds. 12 CFR 703.100(j). Section 703.100(j)(2) prohibits an FCU from purchasing an investment with the proceeds from a reverse repurchase agreement if the purchased investment matures after the maturity of the reverse repurchase agreement. 12 CFR 703.100(j)(2). NCUA proposed to permit RegFlex eligible FCUs to purchase securities with maturities exceeding the maturity of the borrowing repurchase transaction in an amount not to exceed the FCU's net worth.

Most of the commenters supported the proposal. Three commenters objected to the proposed rule because they believed there should be no restrictions on the maturity of any investment purchased by any FCU. These commenters indicated there are no similar restrictions applicable to other types of borrowing. NCUA believes the limitation is prudent and does not unduly impede any FCU's ability to manage its balance sheet and, therefore, adopts the proposed revision in the final rule.

5. Investment Repurchase Transaction

The proposed rule changed the term ''repurchase transactions'' to ''investment repurchase transactions'' and revised the requirements for investment repurchase transactions to be consistent with those of securities lending transactions. Other than these revisions, the proposal did not make any substantive amendments in this regard. No commenter objected. NCUA adopts the proposed revisions.

6. Securities Lending Transaction

Former § 703.100(k) addresses securities lending transactions and requires an FCU to take a perfected first priority security interest in all collateral the FCU receives. 12 CFR 703.100(k). Proposed § 703.13 removes the word ''perfected'', but still requires a first priority security interest through possession or control of the collateral. In addition, the proposed rule clarifies that an FCU's agent may act in its place in these transactions. No commenter objected. NCUA adopts the proposed revisions as final.

7. Recordkeeping and Generally Accepted Accounting Principles

The Act provides that the accounting principles applicable to reports or statements required to be filed with NCUA by insured credit unions, except those with total assets of less than $10 million, must be uniform and consistent with generally accepted accounting principles (GAAP). 12 U.S.C. 1782a(a)(6)(C). NCUA proposed to revise part 703 to clarify that FCUs having total assets of $10 million or more must comply with all GAAP provisions related to the accounting principles applicable to reports or statements required to be filed with NCUA, not just selected ones. While not mandatory for FCUs with total assets of less than $10 million, NCUA encourages them also to comply with GAAP or to account for their investments consistent with the NCUA Accounting Manual for Federal Credit Unions, which can be found on the NCUA website. No commenters objected. NCUA adopts this amendment.

8. Net Worth

To be consistent with changes in the Act and NCUA's rules, NCUA proposed to replace the term ''net capital'' with ''net worth.'' No commenter objected to this change. NCUA adopts it in the final rule.

9. Format

The proposal changed the question and answer format to a more traditional format to make the rule easier to read and more conducive to finding information quickly. Many commenters supported this amendment and no commenters objected to it. NCUA adopts it in the final rule.

10. State-Chartered Credit Unions

One commenter noted that State-chartered credit unions that make investments that are impermissible for FCUs must reserve for those non-conforming investments. 12 CFR 741.3. The commenter questioned whether State-chartered credit unions need to reserve for non-conforming investments that are permissible for RegFlex eligible FCUs. NCUA believes that, if a State-chartered credit union meets all the criteria for RegFlex eligibility as detailed in § 742.2, then it is not required to reserve for non-conforming investments that are permissible for RegFlex eligible FCUs. 12 CFR 742.2. If at any time a State-chartered credit union fails to meet the RegFlex eligibility criteria, then it must reserve for any non-conforming investments it owns.

Another commenter urged NCUA to revise proposed § 703.1, the purpose and scope section, to clarify that State-chartered credit unions, in addition to complying with the reserve requirement for non-conforming investments in § 741.3, must also comply with the requirements of part 703 concerning transacting business with corporate credit unions, as provided in § 741.219. 12 CFR 741.219. NCUA believes it will be helpful to include this reference in the purpose and scope section and is including it in the final rule as a technical correction.

11. Other Technical Corrections

Proposed § 703.16(a) incorrectly references § 703.14(h). The correct and intended reference, reflected in the final rule, is to § 703.14(g).

Proposed § 703.3(g) stated that only ''*those individuals with investment authority* may be voting members of an investment-related committee.'' (Emphasis added.) The former version of the rule requires that only ''*officials and employees of the Federal credit union* may be voting members of an investment-related committee.'' (Emphasis added.) This was an unintended change in language. NCUA received no comment on this but wishes to clarify that the prior language in part 703 remains unchanged as intended by the proposal.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under $1 million in assets). This rule clarifies the investment authority granted to FCUs and conforms the Regulatory Flexibility Program to the investment rule. The final amendments will not have a significant economic impact on a substantial number of small credit unions and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The current Office of Management and Budget control number assigned to part 703 is 3133–0133. NCUA has determined that the final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule would not have substantial direct effects on the States, on the connection between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999–Assessment of Federal Regulations and Policies on Families

NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR part 703

Credit unions, Investments.

12 CFR part 742

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on May 22, 2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Loan Interest Rates

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The current 18 percent per year federal credit union maximum loan rate is scheduled to revert to 15 percent on September 9, 2003, unless otherwise provided by the NCUA Board (Board). A 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions. At the same time, prevailing market rates and economic conditions do not justify a rate higher than the current 18 percent ceiling. Accordingly, the Board hereby continues an 18 percent federal credit union loan rate ceiling for the period September 9, 2003 through March 8, 2005. The Board is prepared to reconsider the 18 percent ceiling at any time should changes in economic conditions warrant.

DATES: Effective September 5, 2003.

FOR FURTHER INFORMATION CONTACT: Daniel Gordon, Senior Investment Officer, Office of Strategic Program Support and Planning, at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428, or telephone 703–518–6620.

SUPPLEMENTARY INFORMATION:

Background

Public Law 96–221, enacted in 1980, raised the loan interest rate ceiling for federal credit unions from one percent per month (12 percent per year) to 15 percent per year. 12 U.S.C. 1757(5)(A)(vi). The law also authorized the Board to set a higher limit, after consulting with Congress, the Department of Treasury and other federal financial agencies, for a period not to exceed 18 months, if the Board determined that: (1) money market interest rates have risen over the preceding six months; and (2) prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

On December 3, 1980, the Board determined that the foregoing conditions had been met. Accordingly, the Board raised the loan ceiling to 21 percent. In the unstable environment of the first half of the 1980s, the Board lowered the loan rate ceiling from 21 percent to 18 percent, effective May 18, 1987. This action was taken in an environment of falling market interest rates from 1980 to early 1987. The ceiling has remained at 18 percent to the present. The Board believes retaining the 18 percent ceiling will permit credit unions to continue to meet their current lending programs and permit the necessary flexibility for credit unions to react to any adverse economic developments.

The Board would prefer not to set loan interest rate ceilings for federal credit unions. Credit unions are cooperatives and establish loan and share rates consistent with the needs of their members and prevailing market interest rates. The Board supports free lending markets and the ability of federal credit union boards of directors to establish loan rates that reflect current market conditions and the interests of their members.

Congress, however, has imposed loan rate ceilings since 1934, and, as stated previously, in 1980, Congress set the ceiling at 15 percent but authorized the Board to set a ceiling in excess of 15 percent, if conditions warrant. The following analysis justifies a ceiling above 15 percent, but at the same time does not support a ceiling above the current 18 percent. The Board is prepared to reconsider this action at any time should changes in economic conditions warrant.

Money Market Interest Rates

Although money market interest rates have generally declined, the Board of Governors of the Federal Reserve System's (the FRB's) aggressive monetary policy and larger anticipated federal budget deficits suggest money market rates will rise in the months ahead. Recent statements by the FRB Chairman Alan Greenspan and other FRB officials suggest they anticipate stronger growth in the remaining months of 2003. This growth also would lead to higher money market interest rates.

These expectations are revealed in the implied forward yield curve for the United States Treasury securities. As of July 11, 2003, the forward yield curve anticipates that: the one-year Treasury yield will rise 51 basis points; the two-year Treasury will rise 63 basis points; and the five-year Treasury will rise 57 basis points by July 11, 2004. In addition, recently there has been an increase in current interest rates, as follows in Table 1:

TABLE 1.—CHANGE IN U.S. GOVERNMENT YIELDS

June 13, 2003–July 11, 2003

Maturity	Rate 6/13/03 (percent)	Rate 7/11/03 (percent)	Change (percent)
3-month	.85	.88	.03
6-month	.94	.94	.10
2-year	1.08	1.33	.25
3-year	1.31	1.66	.35
5-year	1.03	2.52	.49
10-year	3.11	3.67	.57

Lowering the ceiling now, only to revise it upward in several months, would be disruptive to credit unions, as discussed below.

Financial Implications for Credit Unions

For at least 499 federal credit unions, representing 8.5 percent of reporting federal credit unions, the most common rate on unsecured loans was above 15 percent at year-end 2002. While the bulk of credit union lending is below 15 percent, small credit unions and credit unions that have implemented risk-based lending programs require interest rates above 15 percent to maintain liquidity, capital, earnings, and growth. Loans to members who have not yet established credit histories or have weak credit histories have more credit risk. Credit unions must charge rates to cover the potential of higher than usual losses for such loans.

There are undoubtedly more than 499 federal credit unions charging over 15 percent for unsecured loans to such

members. Many credit unions have ''credit builder'' or ''credit rebuilder'' loans but report only the most common unsecured loan rates on NCUA Call Reports. Lowering the interest rate ceiling for federal credit unions would discourage these credit unions from making certain loans and many of the affected members would have no alternative but to turn to other lenders who charge higher rates.

Small credit unions would be particularly affected by lower loan rate ceilings since they tend to have higher levels of unsecured loans, typically with lower loan balances. Table 2 shows the number of federal credit unions in each asset group where the most common rate is more than 15 percent for unsecured loans.

TABLE 2.—ACTIVE FEDERAL CREDIT UNIONS WITH MOST COMMON UNSECURED LOAN RATES GREATER THAN 15 PERCENT

December 2002

Peer group by asset size (in millions)	Total all FCUs	Number of FCUs with greater than 15 percent
$0–2	1,271	106
2–10	1,897	204
10–50	1,742	124
50+	990	65
Total	5,900	499

Should the interest rate charged on loans be subject to a 15 percent ceiling, a number of federal credit unions, where the majority of members are low-income, will incur significant financial strain. Approximately 15 percent of federal credit unions with low-income designation report loan interest rates greater than 15 percent. In contrast, only 8.5 percent of all credit unions report rates above 15 percent. Approximately 17 percent of low-income credit unions with assets less than $10 million would be affected.

These credit unions offset the cost of generating low-balance loans by charging increased interest rates. These credit unions generally are not able to provide credit card loans and, instead, grant closed-ended and open-ended loans with the prerequisite underwriting documentation. Further, these smaller credit unions generally maintain a higher expense ratio, since many are involved with high-transaction accounts requiring higher personnel costs and related operational expenses, and lack economies of scale.

Further, among the 499 federal credit unions where the most common rate is more than 15 percent for unsecured loans, 83 have 20 percent or more of their assets in this category and all but three credit unions have assets of less than $10 million. For these credit unions, lowering the rates would threaten their liquidity, capital, earnings, and growth.

The Board has concluded that conditions exist to retain the federal credit union interest rate ceiling of 18 percent per year for the period September 8, 2003 through March 8, 2005. Loans and line of credit balances existing on or before March 8, 2005 may continue to bear interest at their contractual rate, not to exceed 18 percent. Finally, the Board is prepared to reconsider the 18 percent ceiling at any time during the extension period should changes in economic conditions warrant.

Regulatory Procedures

Administrative Procedure Act

The Board has determined that notification and public comment on this rule are impractical and not in the public interest. 5 U.S.C. 553(b)(3)(B). Due to the need for a planning period before the September 9, 2003 expiration date of the current rule, and the threat to the safety and soundness of individual credit unions with insufficient flexibility to determine loan rates, final action on the loan rate ceiling is necessary.

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (those under ten million dollars in assets). This final rule provides added flexibility to all federal credit unions regarding the permissible interest rate that may be used in connection with lending. The NCUA Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions.

Paperwork Reduction Act

NCUA has determined that this rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interest. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule applies only to federal credit unions and, thus, will not have substantial direct effects on the states, on the relationship between the national government and the states, nor materially affect state interests. The NCUA has determined that the rule does not constitute a policy that has any federalism implication for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Loan interest rates.

By the National Credit Union Administration Board on July 31, 2003.

Becky Baker,

Secretary to the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702, 704, 712, 723, 742

Prompt Corrective Action; Corporate Credit Unions; Credit Union Service Organizations; Member Business Loans; Regulatory Flexibility Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its member business loan (MBL) regulations to provide greater flexibility to credit unions to meet the business loan needs of their members within statutory limits and appropriate safety and soundness parameters. Major changes include: (1) Reducing construction and development loan equity requirements; (2) allowing RegFlex credit unions to make their own decisions whether to require personal guarantees by principals; (3) allowing well-capitalized credit unions to make unsecured MBLs within certain limits; (4) providing that purchases of nonmember loans and nonmember participation interests do not count against a credit union's aggregate MBL limit, subject to an application and approval process; (5) allowing 100% financing on certain business purpose loans secured by vehicles; (6) providing that loans to credit unions and credit union service organizations (CUSOs) are not MBLs for purposes of the rule; and (7) simplifying MBL documentation requirements. Other provisions in the MBL regulation are simplified and unnecessary provisions are removed. In addition, NCUA is amending the prompt corrective action (PCA) rule regarding the risk weighting of MBLs and the CUSO rule to permit CUSOs to originate business loans.

DATES: This rule is effective October 31, 2003.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: David M. Marquis, Director, Office of Examination and Insurance, at the above address or telephone (703) 518–6360; Robert M. Fenner, General Counsel, or Chrisanthy J. Loizos, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

On March 27, 2003, the NCUA Board issued a Notice of Proposed Rulemaking to amend the MBL rule and other rules as they relate to business lending. 68 FR 16450, Apr. 4, 2003. In the proposed rule, the Board provided some parity for federal credit unions (FCUs) with federally insured, state-chartered credit unions (FISCUs) that are exempt from NCUA's MBL rule because the Board had determined that their chartering states had developed MBL rules that minimize risk and accomplish the overall objectives of NCUA's rule. The parity provisions in the proposed rule addressed construction and development loan equity requirements, personal guarantees by principals, and unsecured MBLs. The proposed rule also revised certain provisions that have created unnecessary regulatory burden and clarified certain provisions that have caused confusion. These proposed amendments related to: the dollar amount that triggers compliance with the rule, the loans to one borrower limit, the aggregate MBL limit, loan-to-value (LTV) requirements, MBL documentation requirements, and the loan loss reserve requirements. The Board also proposed that credit unions that purchase participation interests in MBLs made to credit union members need not count the purchase against the credit union's own limit. Finally, the proposed rule expanded the current standard risk-based net worth (RBNW) component for MBLs in the PCA rule and authorized CUSOs to originate business loans.

In the preamble to the proposed rule, the Board noted that the proposed amendments to the MBL rule would allow credit unions greater opportunities to meet the small business loan needs of their members without creating undue risk to the National Credit Union Share Insurance Fund. The Board cautions, however, that MBLs are not suitable for all credit unions. Credit union management must demonstrate a higher standard in planning, policies, procedures, controls, monitoring, credit risk, and diversification to safely establish a long-term strategy in member business lending.

B. Comments

General

NCUA received three hundred and ninety timely comment letters on the proposed rule. NCUA staff, however, credited multiple comment letters from the same commenting organization as one comment letter for a total of three hundred and fifty-one letters. NCUA received comments from two hundred and seventy-six credit unions, twenty-five credit union trade organizations, one CUSO, two corporate credit unions, one corporate CUSO, one CUSO trade organization, two law firms, two consultants, one journalist, fourteen bank trade organizations, twenty banks, one federal agency, one association of state supervisors, three credit union members, and one letter from two members of the U.S. House of Representatives.

Two hundred and ninety-two commenters generally supported the Board's proposal. Many of these commenters stated the changes would improve the ability of credit unions to meet the small business loan needs of their members. Others noted that credit union members need an affordable source of funds to finance and grow their small businesses. They said the proposed rule allows credit unions the ability to serve all of their members' financial needs. Some commenters stated small business owners need every available resource to continue to operate in a competitive economy and that low cost MBLs would allow many businesses to continue their efforts at economic success. They also noted small businesses are the backbone of our nation's economy and are often owned and operated by credit union members. One commenter stated that, as an ex-banker, he felt strongly that many small businesses face unmet credit needs today due to minimum loan amount requirements by large banks and bank holding companies.

Commenters also found that the proposed rules reduce some of the expense burden associated with the current regulations and provide a more manageable solution to business lending. These commenters stated credit unions, their members, and small businesses will benefit from these changes. Several commenters said the current rules are overly restrictive vis-[agrave]-vis the competitive marketplace and that the restrictions have forced members to take their small business loan needs to other financial institutions, although they would prefer to do business with the credit union. One commenter stated that the need for small business capital is a niche that credit unions should be allowed and encouraged to fill. This commenter also noted that as not-for-profit cooperatives, credit unions exist to fulfill the legitimate demands of their members, including their demand for MBLs.

NCUA also received a letter from two members of Congress on the House Financial Services Committee stating that, as authors of the Credit Union Membership Access Act (CUMAA), they were pleased to see that the NCUA Board used the latitude that was appropriately conferred upon the agency by law in preparing these

beneficial changes. 12 U.S.C. 1757a, Public Law 105–219, 112 Stat. 913 (1998). The congressional representatives urged the Board to fully utilize the discretionary authority conferred on it by Congress to facilitate credit union lending in this important and oftentimes underserved area, and to refrain from imposing any limitations upon credit union member business lending not explicitly called for by Congress when it enacted CUMAA.

Thirty-three bank-affiliated commenters strongly opposed the proposed changes to NCUA's MBL rule, stating the proposed amendments are contrary to congressional intent to limit business lending by credit unions. These commenters stated the proposed amendments significantly erode congressional intent when it adopted CUMAA and that Congress made it perfectly clear that credit unions should be focused on consumer lending, not commercial lending. These commenters also stated the proposed rule will divert credit union resources to financing commercial enterprises, while relaxing safety and soundness regulations associated with MBLs.

Three bank commenters stated it is a tremendous mistake to encourage the growth of tax-exempt businesses, particularly when that growth comes at the expense of tax-paying businesses. One commenter stated its organization does not oppose the liberalization of the current MBL rule but does oppose continued tax exempt status for credit unions engaged in commercial lending. Three bank commenters stated the rule creates additional unfair competition with America's small community banks because small business loans are an essential part of their loan portfolio and are what they call their ''bread and butter'' loans. They noted that, without business loans, their existence is jeopardized. Two bank commenters stated credit unions should not be in commercial lending at all.

The U.S. Department of Treasury submitted a comment letter supporting the commitment of credit unions to their members through MBL programs, but objecting to certain provisions of the proposed rule. The Treasury Department objected to the proposed treatment of participation interests, suggesting that the proposal would undermine the intent of Congress with respect to limitations on credit union business lending. The Treasury Department also commented that the proposed removal of the personal guarantee requirement and the proposed authority to make unsecured MBLs may raise safety and soundness concerns by eliminating key provisions that have limited credit risk on MBLs.

Other Suggestions

Commenters offered numerous suggestions to amend the MBL rule that are outside the scope of the issues on which the Board sought comment. The most significant comments dealt with altering the MBL rule so that it could be better aligned with lending programs offered by the Small Business Administration (SBA); changing the LTV definition; and clarifying other provisions in the current MBL rule. NCUA is reviewing these comments and will assess whether to amend the MBL rule further at a future date, in compliance with its responsibilities under the Administrative Procedure Act, 5 U.S.C. 553, to offer the public the opportunity to review and comment on any proposed amendments.

C. Section-by-Section Analysis

Loans to Credit Unions and CUSOs, Sections 723.1(c), 704.11(b)

Paragraph (c) of § 723.1 clarifies that loans made by federal, natural person credit unions to other natural person credit unions and CUSOs are not MBLs because the Federal Credit Union Act grants FCUs express authority to lend to credit unions and CUSOs, in addition to their authority to make MBLs. 12 U.S.C. 1757(5)(C), (D). It also permits FISCUs to exclude loans to credit unions and CUSOs in calculating their aggregate MBL limit if the state supervisory authority determines that FISCUs have authority to lend to credit unions and CUSOs separately from the general authority to grant loans to members. In the absence of authority similar to that in the Federal Credit Union Act, a FISCU's loans to credit unions and CUSOs are subject to the MBL rule.

The final rule includes a corresponding amendment to NCUA's corporate credit union rule to conform to the MBL rule regarding loans to corporate CUSOs by removing the requirement that a corporate credit union's loans to corporate CUSOs be included in the MBL rule's aggregate loan limit, 12 CFR 704.11(b)(4).

Forty-six commenters specifically supported the clarification that loans to credit unions and CUSOs are not MBLs. Two of these commenters supported this exclusion from the MBL limit because they stated a credit union should be allowed to use the entire percentage of its MBL cap to make MBLs, as intended. Many of the commenters stated the clarification eliminates confusion when calculating MBL caps. They noted credit unions are already restricted in the aggregate amount they can lend to a CUSO by law or regulation and are permitted by law to make loans to other credit unions. One commenter noted many smaller credit unions receive deposits from larger credit unions and many credit unions make loans to each other. This commenter stated these loans represent the cooperative spirit of credit unions and are not MBLs. Three commenters stated credit unions may lend to other credit unions or CUSOs for investment purposes; excluding such loans from the MBL rule preserves those investment options while affording a credit union more opportunity to grow a business loan portfolio aimed at the commercial or agricultural needs of the membership.

Two commenters stated the language in the proposed rule wrongly provided for FISCUs to exclude loans to credit unions and CUSOs only if there is independent authority for such loans under state law. They noted the state's authority may be statutorily specific, statutorily implied, by regulation, or by agency interpretation and that the provision should be revised accordingly. The Board agrees and revised the language in the final rule to address this concern by removing the requirement that there be independent authority in state law.

Ten commenters agreed that corporate credit union loans to corporate CUSOs should not be subject to the aggregate MBL limits. Some of these commenters supported the change because these loans serve as investments for corporate credit unions and corporate credit unions are the liquidity providers for the credit union movement. The Board notes that, while they need not include loans to corporate CUSOs in calculating their aggregate MBL loan limit, corporate credit unions remain subject to § 704.11(c), which specifically requires them to comply with certain due diligence requirements in the MBL rule for loans to corporate CUSOs.

Loan Participations, Section 723.1(d), (e)

Paragraph (d) of § 723.1 requires a credit union to subject purchased business loans or participation interests in business loans that another lender made to members of the purchasing credit union to parts 723 and 702 as if the credit union had originated the loans to its members. Paragraph (e) of § 723.1 permits a credit union to exclude purchased business loans or participation interests in business loans that another lender made to nonmembers of the purchasing credit union from the MBL aggregate limit

under the conditions set forth in § 723.16.

Section 723.1(d) of the proposed rule provided that any interest obtained in a participation loan would be excluded in determining the purchasing credit union's aggregate MBL limit but that the participation interest would otherwise be treated the same as a business loan made by the credit union. The effect of this proposal was to subject purchased participation interests in business loans to all of the safety and soundness requirements of NCUA's rules, without requiring the purchasing credit union to count participation interests in loans originated by other lenders against its aggregate MBL limit. While the proposal did not specifically address purchases of whole loans, authorized for RegFlex credit unions pursuant to 12 CFR part 742, the same logic would apply to those purchases.

Credit union commenters were largely supportive of the proposal, although some questioned the basis for distinguishing between loans originated by a credit union and those purchased from another lender. Banks and their representatives argued that the proposal was inconsistent with congressional intent to limit business lending by credit unions, and that it presented unfair competition to community bankers. The U.S. Treasury Department commented that the proposed treatment of participation interests would create a ''loophole'' to escape the aggregate limit on individual credit unions established by Congress. On the other hand, two congressional sponsors of the CUMAA urged NCUA to use its maximum flexibility to enable credit unions to meet their members' business loan needs.

The Board has made two changes from the proposed rule to address the concerns raised by the commenters and ensure that the treatment of loan purchases and participation interests does not result in circumvention of the aggregate limit. First, the final rule provides that, if a credit union holds an interest in a business purpose loan of its member, the interest will be treated the same irrespective of whether it was made by the credit union or purchased from another lender. If a loan is to a credit union's own member for more than $50,000, and not otherwise excluded from the definition of an MBL, the credit union must treat it as an MBL for all purposes, including the aggregate limit. This change is accomplished by adding a new subsection (d) to § 723.1, ''What is a Member Business Loan?'' The new subsection clarifies that purchased member loans and member participation interests are MBLs for all purposes under the final rule.[1] Second, with respect to nonmember loans and nonmember participation interests, the final rule provides that they will be treated the same as an MBL for all purposes except the aggregate MBL limit. The total of such nonmember loans, when added to member loans, may exceed the aggregate limit on member loans only if approved by the NCUA Regional Director pursuant to an application and review process. Section 723.1(e) reflects this change and contains a cross reference to new § 723.16(b) that establishes the application process. The reasons for this treatment of nonmember loans are addressed in detail in the discussion of § 723.16 below.

Construction and Development Lending, Section 723.3

Section 723.3 sets a new borrower equity requirement and establishes exceptions to the limits imposed on construction and development MBLs. This section requires a borrower to have a minimum of a 25%, rather than a 35%, equity interest in any construction or land development project. It also creates specialized standards for financing the construction of single-family residential properties by professional homebuilders by excluding these MBLs from the aggregate construction and development MBL aggregate limit and the borrower equity requirement under certain circumstances.

Ninety-four commenters welcomed the reduced borrower equity requirement of 25%. Many of these commenters stated this minimum equity interest requirement should provide sufficient collateral for a credit union and adequate incentive for a borrower to complete a project. Some commenters stated the lowered equity interest requirement will help credit unions assist more small business owners and put credit unions on equal footing with other financial institutions. Twenty-two commenters said the revision will provide flexibility for both the borrower and the credit union without negatively impacting safety and soundness. One commenter noted that lowering the equity requirement reduces the additional burden on credit unions to secure a waiver from the 35% equity interest requirement.

Eight commenters recommended an even lower percentage for the mandatory equity requirement to be competitive with the market. One stated the requirement should be set at 20% and another suggested that the rule permit waivers to 20%. One commenter asked that the rule allow for a lower percentage when a government agency has provided a guarantee or advance commitment on the loan. Another stated that the proposal was a step in the right direction but would prefer if the minimum equity requirement was lowered to 10% if principals give their personal liability and guarantee. A few commenters raised concerns about the equity requirement in relation to the current rule's definition of LTV. They suggested that the agency adopt the FFIEC Interagency Guidelines for Real Estate Lending that establish supervisory limits on LTV ratios on construction and development MBLs. 12 CFR part 34, subpart D, appendix A.

The final rule retains the equity requirement as proposed. The Board continues to regard the borrower equity interest in construction and development projects and the MBL rule's LTV section, § 723.6, as important tools for safe and sound business lending, just as it did when the Board first adopted these requirements in 1991. ''Collateral requirements are imposed as a hedge against the potential for borrower default. Additionally, LTV ratios implicitly produce powerful incentives to encourage borrowers to repay, *e.g.*, to protect the borrower's equity interest in the property. These incentives do not exist with high LTV ratios, where the borrower has little, if any, equity at risk. Accordingly it is critical that sufficient equity be available to protect the lender's interest.'' 56 FR 48421, 48423, Sep. 25, 1991. The Board also continues to view construction and development loans as containing the largest overall risks to business lending. *See id.* at 48424. It believes, therefore, that the requirement for a borrower to have a 25% equity interest in a construction or land development project is appropriate. A credit union, however, may apply for a waiver of this requirement. 12 CFR 723.10.

The FFIEC Interagency Guidelines for Real Estate may provide more flexibility for other financial institutions because, for example, the Guidelines do not require any equity interest but establish LTV limits for certain transactions. Some of the relevant FFIEC supervisory limits are set as follows: 65% LTV for raw land; 75% LTV for land development; and 80% LTV for commercial construction loans. 12 CFR part 34, subpart D, appendix A. As noted above, however, comments

[1] In addition to the provisions of part 723, credit unions may also be subject to the requirements or authorities granted in other applicable regulations governing loan participations, eligible obligations, and loan purchases by RegFlex designated credit unions. 12 CFR 701.22, 701.23, 742.5.

directed at the rule's LTV definition are not relevant to this current rulemaking because the Board did not seek public comment on any changes to that definition. These comments, as well as the suggestion to review the FFIEC Interagency Guidelines for Real Estate Lending, remain under consideration and may be addressed by future rulemaking.

Finally, commenters asked for clarification about the borrower's equity requirement and whether it is based on the cost amount of the project or the appraised value of the project upon completion. In NCUA legal opinion 01–0422, dated June 7, 2001, the Office of the General Counsel stated that a borrower's equity interest in a project may include down-payment money and the value of land owned by the borrower on which the project is to be built, less any liens. The legal opinion letter also states that, because construction and development projects are typically very speculative in nature, appraisals that attempt to determine the future market value of the completed project tend to be unreliable. Accordingly, NCUA believes it is more prudent to use the market value of the project at the time the loan is made to determine the value of the financed project. This includes the appraised value of land owned by the borrower on which the project is to be built, less any liens, plus the cost to build the project. To adopt the agency's position and clarify this issue for commenters, the final rule states that credit unions must use the current market value of the project in determining its value.

Section 723.3 reduces the regulatory burden for members engaged in the business of constructing single-family residential properties. First, in the case of a loan to finance the construction of a single-family residence where a contract already exists between the builder, who is a member-borrower, and a prospective homeowner, the final rule provides that such a loan is not subject to the aggregate 15% of net worth limit of § 723.3(a) or the 25% equity interest requirement. These loans need only comply with the LTV requirements of § 723.7. Second, the final rule grants this same relief from the aggregate net worth limit and the equity interest requirement for one construction or development loan per member-borrower or group of associated member-borrowers for a single-family residence, irrespective of the existence of a contract with a prospective homeowner.

When making construction and development loans that are exempt from the equity requirements in § 723.3 but subject to the LTV requirements of § 723.7, credit unions must use the market value of the project at the time the loan is made, as discussed above, when determining the appropriate LTV limits.

Eleven commenters supported the exemptions for the financing of single-family residential properties. Several of these commenters stated that the Federal Credit Union Act charges credit unions to extend credit for provident purposes. They found the exclusions for the construction of single family residences enable credit unions to assist their members in achieving home ownership because increased credit union construction financing will enhance the marketplace for readily saleable homes in every community. In short, they stated this regulation opens a door for credit unions to increase the types of service they can offer to their communities.

Two commenters asked for clarification on these provisions because they were unclear as to the number of loans a member homebuilder may have with the credit union under these exclusions. The final rule allows the homebuilder to have as many loans as it has sales contracts with future homeowners, plus one loan for a home for which the homebuilder does not yet have a sales contract, subject to the loans to one borrower limit in § 723.8. When the credit union applies the rule's exceptions to its first speculative-type loan made to a homebuilder, that loan remains exempt from the 25% equity requirements and excluded from the 15% net worth limit of § 723.3 until the builder pays off the loan. Once it is fully paid, the credit union may exclude a new speculative loan made to the builder from the 15% net worth limitation and subject the loan to the LTV requirements of § 723.7. This is contrasted with an outstanding speculative loan to the builder. The credit union cannot exclude an outstanding speculative loan it made during the time the builder was repaying the first exempt loan because any additional speculative loans to the builder during that time must have been made under all of the conditions of § 723.3.

Three commenters noted that the proposed § 723.3(b) excluded certain construction loans if the prospective homeowner contracted to purchase and reside in the property, but that typically prospective homeowners do not contract to reside in a property. They asked, therefore, that this wording be removed. The Board agrees and amended the final rule accordingly. These commenters also asked the Board to expand the exclusion to one-to-four family dwellings. The final rule maintains the more restrictive provision as proposed, limiting the exclusions to single-family residences. The Board has determined not to extend the exclusion to multi-family dwellings as these dwellings have an investment component for the purchaser.

Direct Experience Requirement, Section 723.5

The final rule amends this section by requiring that the person meeting the rule's mandatory two years of direct experience requirement have sufficient experience given the complexity and risk exposure of the credit union's MBLs. It also requires that a third party meeting the experience requirement be independent from the transaction, but establishes three exceptions from this standard.

Seventy-four commenters supported the agency's intent for this proposal. Most of these commenters stated that the rule would make it easier to find individuals qualified to act as an MBL officer by allowing credit unions to engage the services of a third party with direct experience in MBLs under certain conditions so as to avoid potential conflict of interest. They also stated that it allows credit unions to make MBLs without creating a costly infrastructure to meet the experience requirement. The Board wants to clarify that credit unions have been able to use third parties to meet the experience requirement since the 1991 final MBL rule. 56 FR 48421, Sept. 25, 1991. This rulemaking bolsters the experience requirement by ensuring that the individual's experience is relevant to the types of MBLs the credit union makes and that the individual does not have interests that conflict with the credit union's interests.

Six commenters asked for clarification regarding the agency's standard for the requisite lending experience. In 1999, the Board stated that the ''experience requirement can be met by either general business lending experience or experience with granting loans for a particular purpose or secured by a particular collateral.'' 64 FR 28721, 28723, May 27, 1999. The final rule has a more specific standard requiring a credit union to obtain the services of someone with experience tailored to the credit union's needs. Individuals who meet the requirements of this section must have lending experience directly related to the type of MBLs the credit union intends to offer. These individuals must be familiar with the proper underwriting, analysis, and origination of loans of a particular type in order to understand their complexity and risk exposure. For example, an

individual with experience solely in taxi cab loans does not have the requisite experience necessary to underwrite a loan to the taxi company for a gas station, because the individual will be unfamiliar with related issues that may impact the loan, such as environmental laws applicable to underground storage tanks. Likewise, an individual who only has experience with financing residential real estate for homebuilders does not have sufficient lending experience for the land development and construction, or purchase, of a commercial strip center.

Thirty-three commenters found the prohibition against a third party having an interest or involvement in the transaction too restrictive. Most of these commenters stated that the proposal limited a credit union's ability to use third-party service providers and should not be adopted in the final rule. They stated that, while improper personal financial gain cannot be tolerated, a paid third party's interest and involvement is necessary to provide the assistance many credit unions need to make MBLs. One commenter opposed the requirement stating that it would preclude smaller credit unions from having agreements with larger credit unions that have experience underwriting MBLs and then selling participations to that credit union. Two commenters suggested that, in any transaction in which a third party is retained, a credit union should obtain written disclosures of actual or potential relationships and fee arrangements the third party may have in the transaction. Another commenter stated that the proposal was worded too broadly. The Board agrees that the proposal required some revision. The final rule amends the proposed language to more accurately reflect the Board's concerns by establishing a general conflicts of interest standard and exceptions to the standard.

In order for a credit union to engage in business lending in a safe and sound manner, it is crucial for the credit union to maintain strong internal controls and to have independent, experienced personnel involved in making lending decisions that are in the best interests of the credit union. The credit union must perform its own due diligence, both when the credit union makes MBLs and when it purchases MBLs or MBL participation interests, through the services of an individual who meets the requirements in § 723.5. The final rule does not prevent a third party who has the direct experience necessary for a credit union to make MBLs from providing services to the credit union such as document preparation, annual reviews, or loan servicing.

The final rule generally prevents a credit union from relying on a seller's due diligence and experience when the credit union is purchasing MBLs or participation interests in MBLs from the seller. Regardless of whether the seller is, for instance, another credit union or CUSO, the purchasing credit union cannot meet the direct experience requirements of § 723.5 by depending on the advice of the experienced individual(s) who performed the underwriting for the originating lender unless: (1) Staff for the purchasing credit union performed the loan analysis for the originating credit union; or (2) the CUSO exception in § 723.5(b)(3) applies. The final rule bars a credit union from using a third party who has an interest in either the sale of the loan or the collateral securing the loan. It does not bar a smaller credit union from subsequently selling participations to a larger credit union that had advised the credit union when it originated the MBL.

Under the CUSO exception in paragraph (b)(3), a credit union may comply with § 723.5 when purchasing a participation interest or eligible obligation from a CUSO, if the experienced individual is employed by a CUSO in which the credit union has a ''controlling financial interest'' as determined under the Generally Accepted Accounting Principles, even though the CUSO is both the originator and underwriter of the loan.

Member Business Loan Policy, Section 723.6

This section is amended to require credit unions to adopt analysis and documentation requirements within their MBL policies that are consistent with appropriate underwriting and due diligence standards for the types of MBLs the credit union makes, without detailing required documents. Documentation and underwriting criteria for an MBL may vary depending on the type of business requesting the loan and type of loan requested. The final rule also makes a technical amendment to 12 CFR 704.11(c) to reflect the redesignation of paragraphs in § 723.6.

One hundred and twelve commenters supported the proposal. The vast majority of these commenters noted it would greatly expedite the MBL process by eliminating unnecessary documentation and reducing staff time spent on MBL documentation. Many commenters stated it is appropriate for a credit union to adopt documentation requirements in its own policy relative to the types of loans being made. They said that simpler transactions should be subject to fewer documentation requirements than more complex ones, as long as reasonable standards of safety and soundness are met. The final rule adopts the revisions to § 723.6 as proposed.

Loan-to-Value Ratio, Section 723.7

The final rule makes several amendments to this section. First, the final rule uses plain English to describe the LTV requirements instead of a chart. Second, the final rule retains the personal liability and guarantee requirement but no longer requires RegFlex credit unions to obtain these guarantees from principals. Third, the final rule permits credit unions to make unsecured MBLs, in addition to credit card line of credit programs offered to nonnatural person members, if: (1) The credit union is ''well-capitalized'' as defined in 12 CFR 702.102(a)(1); (2) the aggregate of unsecured MBLs to one borrower does not exceed the lesser of $100,000 or 2.5% of the credit union's net worth; (3) the aggregate of all of the credit union's unsecured MBLs does not exceed 10% of the credit union's net worth; and (4) the credit union addresses unsecured loans in its written MBL policy. The final rule reorganizes the waiver provisions of § 723.10 and permits credit unions to apply for waivers from the unsecured MBLs to one borrower limitation and the aggregate unsecured loan limitation under this section. Finally, § 723.7 excludes MBLs made for the purchase of consumer-type vehicles from the rule's LTV requirements if the vehicle is a car, van, pick-up truck, or sports utility vehicle (SUV) that is used for commercial purposes.

A few commenters favored removing the LTV chart for a plain English description of the LTV requirements. One commenter stated, however, that credit unions may misunderstand the rule's clarification that government guarantees may not be used in place of the collateral requirements of § 723.7. While the Board recognizes the distinction between the rule's collateral requirements and advance commitments or loan guarantees issued by government agencies, the Board believes it is helpful to maintain this clarification in the final rule. As stated in § 723.7(a)(2), the MBL rule does not permit guarantees as replacements for collateral requirements. Borrowers must meet the LTV requirements on the total loan amount from the credit union even if a portion of the loan amount is guaranteed by a government agency. This measure provides the credit union

the necessary security in the event the borrower fails to meet the terms of the government guarantee or commitment. The Board notes this provision does not introduce a new requirement but merely clarifies the existing rule. The final rule also contains a correction by replacing ''minimum'' with ''maximum'' to describe the LTV ratio limits prescribed in § 723.3(a) that are unchanged from the 1999 version of the rule.

Section 723.7(b) requires the personal guarantee of all principals in the case of an MBL to a corporate or other organizational member. The only exception is for certain not-for-profit organizations. The proposed rule would have deleted this requirement and allowed the board of directors of each credit union to determine whether to require personal guarantees through its business loan policies. The proposal noted that states that have received exemptions from the NCUA rule have not required personal guarantees and that there is no indication of increased losses or other safety and soundness problems in those states.

While most commenters supported this proposal, a number of commenters, including some credit unions, objected. The views expressed by these commenters included: (1) That the personal guarantee requirement is one of the key reasons that credit union MBLs have been less risky than those of other lenders; (2) that if the principals are not willing to stand behind an MBL, the credit union should not grant it; (3) that without the guarantee requirement future loss experience will be greater; and (4) increased loss experience will be to the detriment of credit unions generally, not just those comparatively few credit unions that choose to make MBLs. Commenters also noted that the exemptions granted to individual states are relatively new and suggested additional monitoring of those states is warranted before eliminating the requirement altogether.

In response to the comments, and after further consideration of the safety and soundness implications of the proposal, the Board has determined to remove the personal guarantee requirement only for those credit unions having RegFlex status under 12 CFR part 742. The personal guarantee requirement is removed for both federal and federally insured state-chartered credit unions meeting the standards of Part 742. RegFlex credit unions generally have a net worth ratio of 9% or more and a high supervisory rating. The Board believes there is little additional safety and soundness risk to the credit union system in allowing RegFlex credit unions that have MBL programs to make their own decisions about requiring personal guarantees. This change is reflected by amending § 723.7(b), the personal guarantee requirement, to state that it does not apply to RegFlex credit unions, and by amending NCUA's RegFlex rule, at § 742.4, to add § 723.7(b) to the list of regulatory requirements from which RegFlex are exempt. Credit unions that do not have RegFlex status may apply for a waiver from the personal guarantee requirement, as permitted in § 723.10(e).

The Board notes the Office of the Comptroller of the Currency and the Office of Thrift Supervision do not impose a legal requirement on national banks and savings associations to obtain principals' personal guarantees before extending credit to a business, but that personal guarantees are nonetheless an industry practice. The Board also notes that the SBA requires personal guarantees under its microloan, 7(a), and 504 loan programs. The Board, therefore, encourages RegFlex credit unions to consider personal guarantees as a risk mitigation tool.

Thirty-seven commenters supported the provision on unsecured MBLs as proposed. Some of these commenters thought the proposal would enable credit unions to expand the potential number of MBL borrowers they could serve and allow them to be competitive with other financial institutions. One commenter stressed how valuable the increase in the unsecured lending authority is to credit unions that partner with the SBA because SBA guidelines allow lenders to make an SBA loan to a business with sufficient ability to repay the loan, even when there is not enough collateral to cover the whole request. Accordingly, the commenter stated, SBA lenders could often be faced with a loan amount in excess of the value of the collateral, so credit unions need sufficient unsecured lending limits to fund this uncollateralized gap.

Sixty-nine commenters stated that the provisions on unsecured MBLs are too restrictive. These commenters offered various suggestions to relax the limits placed on unsecured loans to one borrower and the aggregate amount of unsecured loans a credit union is permitted to make. Three commenters opposed allowing credit unions to make unsecured MBLs.

Section 723.7(c) of the final rule adopts the provisions on unsecured lending as proposed. While many credit unions have requested that the final rule provide greater latitude, the Board finds it prudent to maintain the proposed limits in order to monitor the manner in which credit unions engage in unsecured business lending. The Board also believes that, until it has the opportunity to evaluate the progress of credit unions with unsecured MBLs, the waiver process is sufficient for those credit unions seeking to exceed the rule's current limitations. The waiver process affords NCUA Regional Directors the opportunity to review the safety and soundness considerations of each applicant's lending program on a case-by-case basis.

Ninety-four commenters supported the exemption from the LTV requirements for consumer-type vehicle MBLs. Many of the commenters stated the change is long overdue because the distinctions between a car loan for business purposes and a car loan for consumer purposes are slim. One commenter stated it supported the proposal because the exclusion includes leases of these vehicles and more than one vehicle to an individual, association, organization or business entity. Eleven commenters asked for clarifications on the vehicles covered under the exemption or an expansion of the exemption. Nine of these commenters asked that the Board extend the exemption to any titled vehicle.

Section § 723.7(e) retains the standard proposed by the Board because it believes that the vehicles covered present little or only minimally greater risk than a comparable consumer loan. The Board opposes extending this exemption to all titled vehicles because there is not a readily available market for all types of titled vehicles as there is for consumer-type cars, vans, pick-up trucks, and SUVs. In taking advantage of this rule exception for certain vehicle MBLs, credit unions should establish lending terms, including collateral requirements, for these loans that reflect best industry practices. The Board notes that sound lending practices require that LTV ratios and the term of the loan be consistent with the depreciation schedule of any vehicle used for a particular type of business.

As stated in the proposed rule's preamble, the Board intends this exclusion to be used to finance business use or combined personal/business use vehicles and not, for example, to finance fleet purchases. One commenter asked the Board to clarify the concept of a fleet of cars. A fleet is defined as ''a group of vehicles, as taxicabs * * *, owned or operated as a unit.'' *Webster's II New Riverside University Dictionary* (1994) at 486. The final rule clarifies that a fleet of vehicles is not included in the vehicle exception to the LTV requirements because, when a business requires the use of a fleet of vehicles, it is likely these vehicles will depreciate

far more quickly than vehicles used for personal use or a combined personal/business use.

Reserves for Classified Loans, Sections 723.14 and 723.15

The final rule deletes and reserves § § 723.14 and 723.15, which addressed the classification of MBLs for losses and reserving requirements, because NCUA's Interpretive Ruling and Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Federally-Insured Credit Unions (FICUs) No. 02–3 provides FICUs the appropriate guidance. 67 FR 37445, May 29, 2002. Six commenters specifically supported the deletion of these provisions.

Effect of Purchased Loans and Purchased Participation Interests, Section 723.16

In the CUMAA, Congress established an aggregate limit on MBLs made by individual FICUs. A credit union is exempt from the aggregate limit if it: (1) Was chartered for the purpose of making MBLs; (2) has a history of primarily making MBLs; (3) serves predominantly low income members; or (4) is a community development financial institution. For credit unions that are not exempt, the amount of the aggregate limit is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's assets. Thus, for credit unions with a net worth ratio of 7% or more, the limit is 12.25% of assets. Also, certain loans, such as those below $50,000 in amount and those covered by a government guarantee, are excluded from the MBL definition. 12 U.S.C. 1757A.

The statutory language establishing the aggregate limit provides that ''no insured credit union may make any member business loan that would result in the total amount of such loans outstanding'' in excess of the limit. 12 U.S.C. 1757a(a) (emphasis added). The Board believes that this language lends itself to several possible interpretations. The narrowest interpretation would apply the limit only to loans made by a credit union to its members and not to loans and loan interests purchased from another lender. A second interpretation would apply the limit to all business loans to a credit union's members, whether made by the credit union or purchased from another lender, but not to purchases of loans or loan interests where the borrower is not a member. The most inclusive interpretation would apply the limit to all business loans, whether made or purchased, and irrespective of whether the borrower is a member.

All FCUs are authorized to purchase participation interests in loans made by other lenders to credit union members. 12 U.S.C. 1757(5)(E); 12 CFR 701.22. The borrower need not be a member of the purchasing credit union, only a member of a participating credit union. 12 CFR 701.22(d)(2). In addition, an FCU generally may purchase eligible obligations of its members from any source if the loans are those the FCU is empowered to grant. 12 U.S.C. 1757(13); 12 CFR 701.23(b). Also, although not specifically addressed in the proposed MBL rule, credit unions eligible for NCUA's regulatory flexibility program are authorized to purchase whole loans from other FICUs, including business purpose loans, irrespective of whether the borrower is a member of the purchasing credit union. 12 CFR 742.5.

In the proposed rule, the Board requested comment on the least constraining interpretation of the aggregate limit on MBLs, that is, only business loans made by a credit union to its members would have counted against the aggregate limit. The Board believes this proposal is consistent with the plain language of the Federal Credit Union Act establishing a limit on member business loans made by a FICU. The Board also believes the proposal is consistent with the congressional intent that credit unions not make business loans at the expense of the consumer loan needs of members and that the credit union system not take on undue risk as a result of over-concentration of MBLs. *See* Senate Report 105–193 for a discussion of congressional intent.

In the proposal, the Board addressed the concern that purchasing MBLs might divert a credit union from its responsibility to extend consumer loans and minimize risk related to concentration of MBLs. The Board noted that a credit union's member-elected board of directors would meet its own members' loan demands first and purchase loans made by other lenders only as a means of placing excess funds to maximize returns to their member shareholders. The proposed rule addressed the safety and soundness concerns both by requiring that the purchasing credit union perform its own due diligence on all purchased loans and loan interests and by treating a purchase as a business loan asset for all other purposes, such as loan-to-one-borrower limits and risk-based net worth requirements.

As previously stated, credit unions and credit union related commenters were supportive of the proposal, but some questioned the basis for distinguishing between originations and purchases. Banks and their representatives argued that the proposal was inconsistent with a congressional intent to limit business lending by credit unions. The U.S. Treasury Department suggested that the proposed treatment of participation interests would create a ''loophole'' to escape the aggregate limit on individual credit unions established by Congress. On the other hand, two congressional sponsors of CUMAA urged NCUA to use its maximum flexibility to enable credit unions to meet their members' business loan needs.

As explained in the discussion of § 723.1(d) and (e) above, the Board has addressed the commenters concerns by making certain changes to the proposed rule. First, the Board has determined that business purpose loans to members should be included in the aggregate limit whether the loan was made by the credit union or purchased from another lender. Thus, for example, if a credit union forms a CUSO to originate business loans to the credit union's members and then purchases those loans from the CUSO, the purchased loans will count against the credit union's limit. This change is addressed in § 723.1(d) of the final rule.

On the other hand, purchases of nonmember loans and participation interests, as authorized under certain conditions in NCUA's rules and some state laws and rules, do not involve the provision of member loan services, and the acquired loan assets are not MBLs. The Board continues to believe that these purchases will be made only as a productive method of placing excess funds after member loan demands are met, and that they need not count against the purchasing credit union's aggregate MBL limit. The Board believes it is important to avoid unnecessary interference with the ability of credit unions to place their excess funds in the manner that best serves the credit union, its members, and the credit union system. A credit union that has, for example, 10% of its assets in MBLs and no further current business loan demand, should be able to place excess funds in participation interests of loans made by another credit union without being concerned that it will bar the purchasing credit union from meeting its own members' future loan needs. Purchasing participation interests, or whole loans in the case of a RegFlex credit union, provides a better rate of return for the credit union and its members as compared to a typical investment asset, provides for risk diversification within the credit union system, and fosters the cooperative spirit that has traditionally existed and continues to exist among credit unions.

Purchased nonmember participation interests, however, remain as loans on the credit union's balance sheet even though, under this regulatory standard, they are not MBLs for purposes of the aggregate MBL cap.

Recognizing that a purchased business loan or participation interest of a nonmember is a business loan asset with all of the attendant risks, the final rule does adopt the proposed rule's treatment of these assets as MBLs for purposes of the safety and soundness requirements of NCUA's regulations. A participating credit union, therefore, must otherwise comply with Part 723 and subject these loans to the PCA risk-weighting standards under Part 702 for MBLs as though the credit union had originated the loans. Thus, for example, the purchasing credit union will be required to do its own independent underwriting review and treat the loan the same as an MBL for purposes such as loan-to-one-borrower limits and construction and development loan limits. This change is accomplished, as previously discussed, by adding a new subsection (e) to § 723.1, ''What is a Member Business Loan? '' This subsection provides that purchased nonmember loans and participation interests are treated the same as MBLs for all purposes under the rule except the aggregate limit.

With respect to the aggregate limit on MBLs for individual credit unions and to address concerns that the proposed rule would have created a loophole enabling credit unions to escape the limit, the final rule requires Regional Director approval of any transaction that would cause the total of purchased nonmember business loans and nonmember participation interests, when added to the credit union's MBLs, to result in an amount in excess of the credit union's aggregate limit on MBLs. If the credit union is a FISCU, the request must be submitted to the state supervisory authority for approval. If the state supervisory authority approves the request, the state supervisor will forward it to the regional director for approval. This is consistent with the treatment of waiver requests for FISCUs under the MBL rule. An application submitted pursuant to this requirement must include a copy of the credit union's business loan policies. The application must confirm that the credit union adheres to all aspects of NCUA's MBL rules with respect to purchases of nonmember business loans and participation interests, except the aggregate MBL limit. The application must include the credit union's proposed loan limit on nonmember loans and nonmember participation interests. Finally, the application must attest that the purchase is not being used, in conjunction with one or more other credit unions, in a manner that has the effect of trading MBLs that would otherwise exceed the aggregate limit. Upon receipt of a completed application, the Regional Director will issue a decision within thirty days. In the case of a FISCU, the regional director will issue a decision within 30 days of receipt of a completed application and the state supervisory authority's approval.

The application requirement responds to commenter concerns that some credit unions may use the authority to purchase nonmember loans as a device to swap loans and evade the aggregate limit. This process will enable NCUA and the state supervisors to ensure that the authority to purchase nonmember loans and participation interests is not used to trade loans and circumvent the aggregate limit. Further, it will ensure that purchasing credit unions have conducted their own independent review and otherwise complied with the safety and soundness requirements of the regulations. The Board notes that the final rule does not permit a credit union to seek approval to exceed the aggregate limit on MBLs for member loans or member participation interests made by the credit union or purchased from another lender. The application requirement regarding nonmember business loans and participation interests is set forth in § 723.16(b) of the final rule.

Net Member Business Loan Balance (NMBLB), Section 723.21

The final rule adopts the phrase ''net member business loan balance'' as a new definition in § 723.21 and uses it in various sections in the rule, including §§ 723.1, 723.3, 723.8, and 723.16. The NMBLB definition is:

> [T]he outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien on the member's primary residence, or insured or guaranteed by any agency of the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

The NMBLB definition reflects NCUA's interpretation of various provisions in the MBL rule since the 1999 MBL rule was issued and incorporates several exclusions derived from CUMAA. This definition is key to determining: whether a loan qualifies as an MBL; which portion of an MBL is included in the calculation of the loans to one borrower limit; and which portion of an MBL is included in the calculation of a credit union's total aggregate MBL limit. The Board notes that, because the NMBLB definition excludes participation interests sold without recourse from the selling credit union's MBL limits, neither the originating credit union nor a participating credit union count participations against their MBL aggregate cap provided, as discussed above, the loan participation is not in a loan made to a member of the participating credit union and the participating credit union has obtained a waiver, if required under the circumstances. The Board also notes the final rule includes language clarifying that participations sold without recourse must qualify for true sales accounting under GAAP so that the rule accurately reflects the agency's interpretation over the last several years.

The proposed rule contained a substantially similar definition using a different term, ''outstanding member business loan balance.'' Several commenters found the definition confusing because the term's use of the word ''outstanding'' did not accurately reflect the calculations required as part of the definition. In effect, the proposed definition required a netting of the various exclusions in the definition. The Board has changed the term to ''net member business loan balance'' and simplified the definition to make it easier to understand.

Seventy-four commenters approved of the proposed definition. Most of these commenters stated it will enable credit unions to easily ascertain the factors involved in calculating the MBL threshold and various limit calculations, as well as providing more flexibility in making MBLs. Three stated the new term recognizes the balances that represent true risk to a credit union. Two bank commenters opposed the new term.

One commenter asked the Board to provide examples to assist credit unions in calculating multiple business purpose loans to one borrower. This commenter asked how much a credit union reports as an MBL when it has $35,000 in business purpose loans to a member and makes a $40,000 business purpose loan to the same member—$40,000, $25,000 or $75,000? The credit union would count the $40,000 loan as an MBL and would comply with all of the requirements of Part 723 in making this loan because the loan caused the

aggregate amount of business purpose loans to the member to exceed the $50,000 threshold in § 723.1(b)(3). The credit union, therefore, must comply, for example, with the rule's direct experience requirements and the LTV standards when making the loan, as well as count the MBL against the credit union's aggregate MBL limit in § 723.16. When the member pays down the amount of the total business purpose loans owed to the credit union so that the aggregate amount falls below the $50,000 threshold, the credit union is no longer required to report the $40,000 loan as an MBL.

For purposes of the loans-to-one borrower limitation under § 723.8, the same calculation applies. The $40,000 MBL applies towards the member's one borrower limit of the greater of 15% of the credit union's net worth or $100,000, until the aggregate amount of business purpose loans held by the member is less than $50,000. The member, however, is still subject to the Federal Credit Union Act's limitation on the total amount of loans made to one borrower of no more than 10% of the credit union's unimpaired capital and surplus. 12 U.S.C. 1757(5)(A)(x).

Another commenter asked for clarification on the manner in which a loan that has a partial guarantee from the SBA is analyzed with the NMBLB definition. As discussed in the 1999 final rule's preamble, a credit union only counts the amount of the loan that is not guaranteed by the SBA towards the $50,000 threshold in § 723.1(b)(3) to determine if a business purpose loan is an MBL. 64 FR 28721, 28722, May 27, 1999. Consistent with this interpretation, a credit union that makes a $100,000 business purpose loan, of which 75% of the loan amount is guaranteed by a government agency, counts only $25,000 towards the MBL threshold. 12 CFR 723.1(b)(3). Because this amount of $25,000 is less than $50,000, the loan is not an MBL and is not subject to Part 723.

This example demonstrates loan analysis for purposes of Part 723:

Loan 1 to Company in January 2003: $40,000.

Loan 2 to Company in February 2003: $80,000 with a 75% government guarantee.

[sbull] Loan 1 is not an MBL because it is under the $50,000 threshold.

[sbull] Loan 2 has an NMBLB of $20,000 (25% of $80,000) but when added to Loan 1, the amount of business purpose loans to the member exceeds $50,000, so Loan 2 is an MBL and must comply with all of the requirements of Part 723.

[sbull] FCU must obtain a lien on Company's collateral valued at $100,000 in order to make Loan 2.

[sbull] FCU counts $20,000 against its aggregate MBL limit and $20,000 towards Company's limit on loans to one borrower.

[sbull] FCU must factor the entire loan amount of Loan 2, $80,000, as an MBL into the standard RBNW calculation of the PCA rule until the loan is fully paid.

Loan 1 is paid down to $15,000 in April 2003.

[sbull] Loan 2 is no longer an MBL for purposes of Part 723 because the total amount of business purpose loans to Company is $35,000.

Loan 3 is a participation purchased in a loan made to Company on May 2003: $25,000

[sbull] Loan 3 is an MBL because combined with the NMBLBs of Loans 1 and 2, Company's aggregate NMBLBs is $60,000.

Loan 4 Unsecured Line of Credit to Company in June 2003: $15,000.

[sbull] Loan 4 is an MBL because Company's aggregate NMBLBs for all four loans totals $75,000, which exceeds the $50,000 threshold.

[sbull] As of June 2003, FCU counts Loan 3's NMBLB of $25,000 and Loan 4's NMBLB of $15,000 against its aggregate MBL cap and against Company's loans-to-one borrower limit.

[sbull] For PCA purposes, FCU calculates the standard RBNW based on the outstanding balances on Loans 2, 3, and 4 in accordance with § 702.106(b).

One commenter asked that NCUA amend its Form 5300 call report instructions to reflect the changes in the final rule. NCUA will amend the call report after the agency gives the public notice and an opportunity to comment on any proposed changes in accordance with the Administrative Procedure Act and the Paperwork Reduction Act of 1995. The Board anticipates that this process will take several months.

The final rule deletes and reserves § 723.9, which addressed calculation of the limit on loans to one borrower, because the NMBLB definition contains all of the rule's exclusions from this calculation, making § 723.9 unnecessary.

Effect of Final Rule on Approved State Rules

State supervisory authorities may continue to seek exemptions for their FISCUs from NCUA's MBL rule as set 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 NMBLB 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 participation agreements with CUSOs or other eligible organizations, FCUs must comply with all applicable regulations, including the MBL rule. *See* 12 CFR 701.22, 701.23.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under $10 million in assets). The final member business loan relaxes some of the rule's existing standards or clarifies current requirements. In addition, less than 5% of small credit unions grant member business loans. The NCUA Board, therefore, has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, a regulatory flexibility analysis is not required.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule liberalizes current requirements and standards applicable to all federally insured credit unions and will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and

Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 712

Credit, Credit unions.

12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 742

Credit unions.

By the National Credit Union Administration Board on September 24, 2003.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 6**

NCUA 8006 (M3500) DATE: December 2003

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 6 to the National Credit Union Administration Rules and Regulations (Revised November 2001)

1. PURPOSE. To update the National Credit Union Administration Rules and Regulations (Revised November 2001) in the following manner:

   a. **Part 701—Organization and Operations of Federal Credit Unions.**

   § 701.21—Loans to Members and Lines of Credit to Members. Revised paragraph (c)(7)(ii)(C).

   b. **Part 702—Prompt Corrective Action.**

   § 702.106—Standard calculation of risk based net worth requirement.

   — *Member business loans outstanding.* Revised paragraph (b).

   — Table 4—Standard Calculation of RBNW Requirement. Revised calculations for line (b) MBLs outstanding.

   Appendices to Subpart A

   — Appendix A—Example Standard Components for RBNW Requirement, § 702.106 (Example Calculation in Bold). Revised the calculations for line (b) MBLs outstanding.

   — Appendix D—Example of Member Business Loans Alternative Component, § 702.107(b) (Example Calculation in Bold). Revised the calculations for the Variable-rate MBLs maturity for 0 to 3 years.

   — Appendix H—Example RBNW Requirement Using Alternative Components (Example Calculation in Bold). Revised the calculations for line "(b) MBLs outstanding"; line "(e) Average-risk assets"; and "RBNW requirement*" in the Standard component column.

c. **Part 704—Corporate Credit Unions.**

§ 704.7—Lending. Revised paragraph (e)(2).

§ 704.11—Corporate Credit Union Service Organizations (Corporate CUSOs).

— Removed paragraph (b)(4).

— Revised the letter (l) to the letter (j) in paragraph (c).

d. **Part 712—Credit Union Service Organizations (CUSOs).**

§ 712.5—What activities and services are preapproved by CUSOs? Redesignated paragraphs (c) to (q) as paragraphs (d) to (r) and added new paragraph (c).

e. **Part 723—Member Business Loans.**

§ 723.1—What is a member business loan? Added the phrase "the net member business loan balances are" after the word "when" in paragraph (b)(3); added paragraphs (c), (d), and (e).

§ 723.3—What are the requirements for construction and development lending? Revised paragraphs (a) and (b).

§ 723.5—How do you implement a member business loan program? Revised by adding new paragraphs (a) and (b).

§ 723.6—What must your member business loan policy address?

— Added the phrase "secured and unsecured" before the word "business" in paragraph (c).

— Added "§ 723.7(c)(2) and" after the words "subject to" in paragraph (e).

— Added a phrase after the word "loan" in paragraph (g).

— Removed paragraphs (h) and (i); redesignated paragraphs (j) to (m) as paragraphs (h) to (k).

§ 723.7—What are the collateral and security requirements? Revised the entire section.

§ 723.8—How much may one member or a group of associated members borrow? Revised introductory paragraph and paragraphs (a) and (b).

§ 723.9—How do you calculate the aggregate 15% limit? Removed and reserved.

§ 723.10—What waivers are available? Revised the entire section.

§ 723.14—How do I classify loans to as to reserve for potential losses? Removed and reserved.

§ 723.15—How much must I reserve for potential losses? Removed and reserved.

§ 723.16—What is the aggregate member business loan limit for a credit union? Revised the entire section.

§ 723.21—Definitions. Added a new definition.

f. **Part 742—Regulatory Flexibility Program.**

§ 742.4—From what NCUA regulations will I be exempt? Removed the words "§ 703.12(c); and § 703.16(b) of this chapter" and replaced with "§ 703.12(c), § 703.16(b), and § 723.7(b) of this chapter" in paragraph (a).

g. **Part 792—Requests for Information Under the Freedom of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information.**

§ 792.07—Where do I send my request? Revised paragraphs (a) through (c).

§ 792.08—What must I include in my request? Revised paragraph (a).

§ 792.10—What will NCUA do with my request? Added paragraph (f).

§ 792.14—Who is responsible for responding to my request? Revised the first sentence and added a sentence after the first sentence.

§ 792.28—What if I am not satisfied with the response I receive? Revised the third sentence of the introductory paragraph.

2. This change also corrects typographical errors and formatting problems found in other parts of the manual.

3. INSTRUCTIONS:

Your November 2001 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
701–5 thru 701–6	701–5 thru 701–6
702–5 thru 702–8	702–5 thru 702–8
702–11 thru 702–14	702–11 thru 702–14
704–9 thru 704–10	704–9 thru 704–10
704–13 thru 704–14	704–13 thru 704–14
712–1 thru 712–4	712–1 thru 712–4
723–1 thru 723–6	723–1 thru 723–6
742–1 thru 742–2	742–1 thru 742–2
792–1 thru 792–4	792–1 thru 792–4
792–7 thru 792–8	792–7 thru 792–8

4. PREAMBLES. Enclosed with Change 6 are the Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 792

Freedom of Information Act; Implementation

AGENCY: National Credit Union Administration (NCUA).

ACTION: Direct final rule with request for comments.

SUMMARY: NCUA is amending its regulation implementing the Freedom of Information Act (FOIA) to reflect changes in its internal procedures for responding to FOIA requests and to provide the public with notice of the cut-off date used by the agency when searching for records responsive to FOIA requests.

DATES: *Effective Date:* This rule is effective December 29, 2003, without further action, unless adverse comment is received by December 1, 2003. If NCUA receives adverse comments, it will publish a timely withdrawal of the rule in the **Federal Register**.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428. Fax comments to (703) 518–6319. E-mail comments to *regcomments@ncua.gov. Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: Dianne M. Salva, Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION: NCUA is changing its FOIA regulation, which establishes agency procedures for requesting access to NCUA records, to provide for centralized processing of FOIA requests. Previously, the rule instructed the public to submit FOIA requests to one of nine offices where they believed the records were located. This de-centralized system required FOIA requesters, some of whom were not familiar with NCUA record keeping practices, to determine where NCUA stored records. Now, the rule provides for just two offices where the public can choose to direct their FOIA requests. If requesters seek records of the Office of Inspector General (OIG), they will submit a request to the OIG. If requesters seek any other type of NCUA record, they will submit a single request to the Central Office, which will search all relevant offices for the records.

The rule also instructs FOIA requesters who are interested in receiving their FOIA responses by electronic mail (e-mail) to include their e-mail address with their requests. This will enable NCUA to process FOIA requests more efficiently and provide more timely FOIA responses.

Finally, the rule provides the public with notice of NCUA's policy concerning the search cut-off date for records responsive to a FOIA request. The U.S. Department of Justice (DOJ), which provides guidance to agencies throughout the federal government on FOIA compliance, recommends that agencies use the date they begin to search for responsive records as the cut-off beyond which no later records are considered within the scope of the request. *Freedom of Information Guide and Privacy Act Overview*, U.S. Department of Justice, May 2002, p. 47. Although in some cases, for administrative reasons, agencies may use another search cut-off date, such as the date of the request, recent case law establishes a general rule that agencies should include all records in existence as of the date the search begins. *Public Citizen* v. *U.S. Department of State*, 276 F. 3d 634 (D.C. Cir. 2002).

In determining what records are responsive to a FOIA request, NCUA has generally used the date it begins its search as a search cut-off date. The NCUA Board (the Board) finds that standard to be most reasonable. The Board also recognizes that in some cases there may be a good reason, such as administrative efficiency, for using a different search cut-off date. This rule, then, provides that NCUA will generally use the date it begins its search as the search cut-off date. If it uses another date, it will advise the FOIA requester.

Under the Administrative Procedures Act (APA), an agency need not comply with the notice and comment procedures for rulemaking when the rule involved is one of agency organization, procedure, or practice. 5 U.S.C. 553(b)(3)(A). These revisions to NCUA's FOIA regulation deal with internal agency practices and policies for receiving and processing FOIA requests. Accordingly, the Board finds that, under the APA, it is unnecessary to solicit public comment before making the rule effective. 5 U.S.C. 553(b)(3)(A). In an effort to provide the public with full opportunity to participate in this change to NCUA's rules, however, the Board has determined to publish this rule as a direct final rule and accept public comments for a period of 30 days prior to the effective date. The Board encourages interested parties to submit comments. If NCUA does not receive adverse comments, the rule becomes effective on the date noted above.

Regulatory Procedures

Paperwork Reduction Act

This regulation will impose no additional information collection, reporting or recordkeeping requirements.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 605(b)), NCUA certifies that this rule will not have a significant economic impact on a substantial number of small entities. NCUA expects that this rule will not: (1) have significant secondary or incidental effects on a substantial number of small entities; or (2) create any additional burden on small entities. These conclusions are based on the fact that the revised regulations are minor procedural changes intended to simplify agency record access and disclosure procedures. Accordingly, a regulatory flexibility analysis is not required.

Executive Order 12612

The NCUA Board has determined that this regulation will not have a substantial direct effect on the States, on the relationship between the national government and the States, or in the distribution of power and responsibilities between the various levels of government.

Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget is reviewing this rule to determine that it is not major for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request your comments on whether the revisions are understandable and minimally intrusive.

List of Subjects in 12 CFR Part 792

Confidential business information, Freedom of information, Government employees.

By the National Credit Union Administration Board on October 23, 2003.

Becky Baker,

Secretary of the Board.