

NATIONAL CREDIT UNION ADMINISTRATION

1775 Duke Street, Alexandria, VA 22314

DATE: August 7, 1998

LETTER NO.:98-CU-16

TO: The Board of Directors and Management of the Federally insured Credit Union

SUBJECT: The Credit Union Membership Access Act of 1998

The Credit Union Membership Access Act of 1998, HR 1151, was signed into law by the President on August 7, 1998. This Act authorizes multiple group chartering for Federal credit unions, and makes other important changes in the Federal Credit Union Act. In many cases those changes affect all federally insured credit unions.

The purpose of this letter is to provide you with information about the contents of the 1998 Act, the implementation dates for the various provisions of the Act, and the rules that will apply in the interim. There are four titles to the Act. Each is addressed separately below.

TITLE I - CREDIT UNION MEMBERSHIP

Title I re-authorizes multiple group chartering for Federal credit unions. Specific criteria and procedures different from those under NCUA's previous multiple group policy will now apply. Title I also limits new community charter applications to well-defined "local" communities, and requires that NCUA define the term "immediate family member" for membership eligibility purposes. Title I applies only to Federal credit unions.

Title I is not self-implementing; NCUA must issue implementing rules. This will be done in the form of a new Chartering and Field of Membership Manual. One of our first priorities under HR 1151 will be to issue a proposed new Chartering Manual for public comment. The proposed Manual will be distributed to all Federal credit unions for comment, most likely with a 30 or 60-day comment period. The NCUA Board expects to issue this proposal August 31st.

After the comment period and a period to evaluate the comments, the new Manual should be in effect within 4 to 6 months from the date of enactment. Also, the final effective date for the definitions of "immediate family member" and well-defined "local" community may take somewhat longer because they are designated by HR 1151 as major rules which must be submitted to Congress 60 days in advance of their effective date.

For the multiple group authority and other provisions of Title I, the following guidelines apply until final new rules are in place:

First, all persons and groups already included within your Federal credit union's field of membership as of August 7, 1998 (the date of enactment of HR 1151), are grandfathered by the Act. This means you may continue to serve those groups and add new members without interruption. You may not, however, add new

select groups until the new chartering rules take effect.

Second, with respect to "family member" eligibility, your Federal credit union may continue to add family members under your existing bylaw until the new rules are in place.

Third, with respect to community charter conversions, if your credit union had an application pending as of August 7, 1998 to convert to a Federal community charter, your application will be processed pursuant to NCUA's existing policies. (If your Federal credit union has an application to convert to a Federal community charter pending, and you wish to withdraw it in view of Congress' re-authorization of multiple group charters, please notify your NCUA regional office.) Any new applications to convert to a Federal community charter or to form a community Federal credit union can be processed only after the new rules defining "local" community are in effect.

Fourth, if your Federal credit union is considering a voluntary merger with another credit union, you must wait until the new rules are in effect unless the credit unions share a single common bond.

Fifth, applications to convert to state charter are unaffected by the new law.

Finally, with respect to Title I, if your credit union wishes to expand by serving a low-income community, you must wait until the new implementing rules are in place, unless you are a community credit union that has already submitted its application as of August 7, 1998.

TITLE II - REGULATION OF CREDIT UNIONS

Title II imposes new requirements on federally insured credit unions with respect to: financial statements and audits; member business loans; and conversions to mutual savings bank or savings association charter.

Financial Statements and Audits

Title II establishes three important new requirements with respect to financial statements and audits. First, all federally insured credit unions with assets of \$500 million or more must obtain an annual independent audit by a certified public accountant or state licensed accountant. Second, all federally insured credit unions with assets of \$10 million or more must follow generally accepted accounting principles for all "reports or statements required to be filed with the [NCUA] Board." Third, for any Federal credit union with assets of more than \$10 million that uses "an independent auditor who is compensated for his services," the audit is subject to state accounting laws, "including licensing requirements."

The first of the three provisions should not present any problems as virtually all credit unions with over \$500 million in assets already obtain an annual CPA audit. The other two provisions will require NCUA to revise its accounting guidelines. We will need to revise our forms for financial statements and reports and address interpretive issues, such as what constitutes an "independent auditor who is compensated." We will issue further guidance as soon as possible, and we will carefully coordinate with the state supervisory authorities. Meanwhile, your credit union may use the forms and methods currently prescribed. For Federal credit unions that have an audit planned or underway using a compensated outside auditor, if you have concerns about the new requirements related to state law and licensing, we recommend that you consult with your auditor and your NCUA regional office.

Member Business Loans

Title II imposes a new aggregate limit on a credit union's outstanding member business loans of 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 your retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other reserves. This limit applies immediately to both Federal and federally insured state credit unions. Member business loans are defined in accordance with Section 701.21(h)(1) of NCUA's current regulation. Thus, for example, if total business loans to one member are less than \$50,000, those loans are not considered member business loans and they are not counted against the new aggregate limit.

There are three circumstances where a credit union may qualify for an exception from the aggregate limit. The three exceptions are: (1) credit unions that have a limited income designation or participate in the Community Development Financial Institutions program; (2) credit unions that have "a history of primarily making member business loans;" and (3) credit unions that were "chartered for the purpose of ... primarily making member business loans."

As of August 7, 1998, unless your credit union qualifies for an exception, you will not be able to make additional member business loans if you exceed the aggregate limit or the loan would cause you to exceed the limit. You will, however, have until August 7, 2001, to bring your existing loans within the limit. The NCUA will provide interim rules or additional guidance on this issue at its September 23, 1998, meeting, at the latest. However, in the meantime, if you believe in good faith that you are covered by an exception, you should memorialize that fact and you may make additional member business loans. We are working closely with the state regulators on this issue. If you have any questions at this time, please contact your NCUA regional office or your state regulator.

Conversion to Mutual Savings Bank or Savings Association Charter

Title II restricts NCUA's authority to regulate conversions by insured credit unions to mutual savings bank or mutual savings association charters. Such conversions may take place "without the prior approval of the [NCUA] Board," as long as the transaction is approved by the Board of Directors of the credit union and by a majority of the members who choose to vote. Title II establishes requirements for notice to members and NCUA, and NCUA's regulatory role is limited to oversight and approval of voting "methods" and "procedures".

NCUA is required to have implementing rules in place for the new conversion provisions within 6 months after enactment of HR 1151. Until those new rules are in effect, NCUA's existing rules will apply. Proposed rules will be issued for public comment this fall. Also, while these provisions of HR 1151 with respect to conversions apply to all federally insured credit unions, they only affect NCUA's authority and do not appear to restrict the ability of the states to regulate conversions by state credit unions, whether or not federally insured. NCUA will work carefully with the state supervisory authorities in developing the required new rules.

TITLE III - CAPITALIZATION AND NET WORTH OF CREDIT UNIONS

New Capital Requirements and Prompt Corrective Action

Title III establishes a new system of tiered capital requirements for all insured credit unions other than corporate credit unions. These new requirements do not take effect until 2 years after the date of enactment of HR 1151 - August 7, 2000. Congress has closely modeled these requirements on provisions that have existed in federal banking law for the last several years.

A new net worth standard of 7% of assets will be established for insured credit unions, as well as risk-based capital standards for "complex" credit unions as defined by NCUA (the risk-based standards will not take

effect until January 1, 2001). For credit unions not meeting these standards, progressively more stringent "prompt corrective action" requirements will apply. The lower the credit union's net worth the more stringent the actions become. For example, all credit unions with less than 7% net worth, and any complex credit union not meeting the risk-based standards, will be required to make a reserve transfer. Credit unions with less than 6% net worth, and any complex credit union not meeting the risk-based standards, will be required to implement a "net worth restoration plan." Administrative actions will apply to credit unions below 4% net worth and to "complex" credit unions below 5% and not meeting risk-based standards. A separate system of prompt corrective action must be developed for "new credit unions." For this purpose, "new credit unions" are defined as credit unions that have been in operation for 10 years or less and have less than \$10 million in assets.

Again, these new provisions, which are mandated by Congress, are not effective until August of 2000 and January of 2001. Implementing rules will be issued well in advance of these dates. Final rules must be issued within 18 months, with the exception of final rules concerning risk-based capital for complex credit unions, which must be issued within 2 years. Also, proposed rules must be issued for public comment within 270 days, and an advance notice of proposed rulemaking concerning risk-based capital for complex credit unions must be issued within 180 days. NCUA will work carefully with the state supervisory authorities in developing these rules, and there will be full public participation. Until the new provisions are in effect, all insured credit unions should continue to operate under the capital requirements and standards of their existing laws and regulations.

National Credit Union Share Insurance Fund

Title III revises the provisions of the Federal Credit Union Act concerning the National Credit Union Share Insurance Fund's equity ratio and NCUA's premium and dividend authority, effective January 1, 2000.

NCUA will be required to use the most current Fund equity and insured share data in determining the equity ratio. NCUA will have the discretion to set the "normal operating level" of the Fund, or the desired equity level, between 1.2 and 1.5%. NCUA will also monitor the Fund's "available assets" ratio --the ratio of liquid Fund assets to total insurance liabilities-- and will pay a dividend only when the available assets ratio exceeds 1% and the equity ratio exceeds the normal operating level.

Also, if the Fund's equity ratio declines below 1.2%, a premium will be required in the amount necessary to restore the ratio to 1.2%. Premiums will be assessed at times determined by the NCUA Board, but no more than twice a year. Finally, insured credit unions with \$50 million or more in assets will be required to adjust their 1% Insurance Fund deposit semi-annually, rather than annually.

Again, these changes with respect to the Insurance Fund do not take effect until January 1, 2000. NCUA will issue proposed rule changes for public comment in early 1999, and final rules in advance of the effective date.

TITLE IV - MISCELLANEOUS PROVISIONS

Title IV has no immediate effect on credit unions. Title IV requires the Treasury Department to conduct three new studies addressing first, the differences in regulation of credit unions and other financial institutions and the potential effects of taxation on credit unions; second, recommendations to reduce and simplify the tax burden on small depository institutions; and third, member business lending by insured credit unions. The Treasury Department must complete each of these studies and report to Congress within 1 year after enactment of HR 1151. Also, pursuant to Title IV, NCUA and the other financial institution regulators must submit reports to Congress, within 1 year after enactment, on our progress in implementing

the 2-year regulatory review that was mandated by the Riegle Community Development and Regulatory Improvements Act of 1994.

CONCLUSION

We hope this letter provides your credit union with useful information concerning what to expect from HR 1151 and the relevant time frames. To further assist in that regard, we have attached a table showing the major regulations required and the expected implementation time frames. Our first priority at NCUA is the rulemaking process that is necessary in order to re-authorize multiple group chartering. Our second is to implement the other provisions of the legislation within all established time periods.

We are committed to full public participation, including participation by credit unions and their representatives, in all rulemaking and policy decisions related to HR 1151. We are committed to working carefully with the state supervisory authorities on all matters affecting federally insured state credit unions. Copies of the legislation and other related materials can be found on NCUA's web site at www.ncua.gov.

If you have any questions concerning this letter or other issues related to HR 1151, please contact your NCUA regional office or your state supervisory authority.

Sincerely,

/S/

Norman E. D'Amours, Chairman

On Behalf of the NCUA Board

Enclosure

HR 1151 IMPLEMENTATION SCHEDULE

| ISSUE | EFFECTIVE DATE OF HR 1151 PROVISION | TARGET DATE FOR PROPOSED RULES | TARGET DATE FOR FINAL RULES |
|---|---|---|-------------------------------|
| 1. Multiple group authority and other FOM changes | No delayed effective date, but not self-implementing | August 31 NCUA Board meeting | 4-6 months |
| 2. Member business loans | Cap effective immediately for new loans, unless an exception is met | Interim rules or guidance at September 23, 1998, NCUA Board meeting | Early 1999 |
| 3. Conversion to savings bank charter | Implementing rules must be issued within 6 months | Fall 1998 | On or before February 7, 1999 |
| 4. Capital and prompt | | | |

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|--|-----------------|--|----------------|
| corrective action -general | August 7, 2000 | May 1999 | February 2000 |
| 5. Capital and prompt corrective action - risk based capital | January 1, 2001 | February 1999-Advance Notice of Proposed Rule-making | August 7, 2000 |
| 6. National Credit Union Share Insurance Fund equity ratio and premium authority | January 1, 2000 | Early 1999 | Fall 1999 |