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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.

■ Accordingly, NCUA amends 12 CFR part 701 as follows:

PART 701—ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

■ 1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717.

Section 701.31 is also authorized by 15 U.S.C. 1601 *et seq.*; 42 U.S.C. 1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

■ 2. Revise § 701.19 to read as follows:

§ 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).

[FR Doc. 03–10614 Filed 4–29–03; 8:45 am]

BILLING CODE 7535–01–P

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