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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 741

Suretyship and Guaranty; Maximum Borrowing Authority

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is revising its rules concerning maximum borrowing authority to permit federally insured, state-chartered credit unions (FISCUs) to apply for a waiver from the maximum borrowing limitation of 50 percent of paid-in and unimpaired capital and surplus (shares and undivided earnings, plus net income or minus net loss). This amendment will provide FISCUs with more flexibility by allowing them to apply for a waiver up to the amount permitted under state law.

NCUA is also adding a provision to its regulations that allows a federal credit union (FCU) to act as surety or guarantor on behalf of its members. The final rule establishes certain requirements to ensure that FCUs, and FISCUs if permitted under state law to act as a surety or guarantor, are not exposed to undue risk.

DATES: This final rule is effective March 26, 2004.

FOR FURTHER INFORMATION CONTACT: Mary F. Rupp, Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

On September 24, 2003, the NCUA Board requested comment on proposed changes to §§ 701.20 and 741.2 of its regulations. 68 FR 56586 (October 1, 2003). Proposed § 701.20 created a new provision to recognize that an FCU, as part of its incidental powers, may act as a guarantor or surety on behalf of a member. Section 741.2 sets forth a maximum borrowing limitation of 50 percent of paid-in and unimpaired capital and surplus for all federally insured credit unions. The proposed amendment permitted federally insured, state-chartered credit unions (FISCUs) to apply for a waiver up to the amount permitted by state law.

B. Summary of Comments

The NCUA Board received 10 comments on the proposal: three from credit unions; three from credit union trade groups; two from credit union leagues; and two from bank trade groups. Below is a summary of the comments.

Suretyship and Guaranty

Eight of the ten commenters support allowing a credit union to act as a surety or guarantor. Two of the eight positive commenters suggested allowing FISCUs to apply for a waiver from the safety and soundness limitations placed on the transactions. One of the positive commenters suggested slightly different collateral requirements. The two negative commenters were the bank trade groups.

The positive commenters noted that allowing credit unions to enter into suretyship and guaranty agreements with the safety and soundness requirements in the proposal will give credit unions additional flexibility to meet the needs of their members while ensuring the safety and soundness of the transaction. The commenters noted that this activity could become a valuable service for credit unions. A couple of the commenters suggested, because this activity is so new for credit unions, that NCUA review the rule after it has been in effect for a few years to address any operational issues that may arise. The Board intends to incorporate this suggestion into its regulatory review process.

Two of the positive commenters suggested allowing FISCUs to apply for a waiver that would allow the state regulator or legislature to authorize more flexible guarantor or surety requirements. They suggest that a waiver only be granted if there are no safety and soundness implications. Because, as some of the commenters noted, this activity is new for credit unions, NCUA believes it is premature to adopt a waiver provision. The Board believes the requirements in the rule that would be the subject of a waiver all relate directly to safety and soundness, however, as NCUA and credit unions gain more experience in this area, the Board may reconsider this issue.

One of the commenters suggested that corporate credit unions have a role to play when a natural person credit union is acting as a guarantor for its member. The commenter recommended including deposits at corporate credit unions in the 100% collateral category. Because it is the natural person member that is providing the collateral and natural person members do not have deposits at corporate credit unions, we do not believe it is appropriate to implement this suggestion.

The two bank trade groups believe allowing credit unions to engage in these transactions conflicts with a credit union's mission of serving people of modest means. They also assert that allowing this activity is an expansion of a credit union's commercial lending powers and should not be allowed as long as credit unions are tax exempt. Congress has specifically authorized commercial lending for FCUs. 12 U.S.C. 1757a. Contrary to the bankers' claims, this rule is consistent with Congress' intent for FCUs with respect to serving their members and business lending.

Waiver of Maximum Borrowing Limitations for FISCUs

Eight of the ten commenters supported this proposal. The two negative commenters were the bank trade groups.

Those in support of the proposal contend that: It is inherent in the concept of dual chartering to allow state-chartered credit unions to exercise powers authorized under state law and regulation within the bounds of safety and soundness; the proposal's approach is similar to the approach used by the other banking agencies; and the waiver provision will assist FISCUs in providing service to low income families by allowing FISCUs to borrow from the Federal Home Loan Bank a greater amount than the regulatory limitation currently permits. Finally, a few of the positive commenters suggested NCUA seek similar authority for FCUs through a legislative change.

The two negative bank commenters expressed concern that the waiver provision could negatively impact on the safety and soundness of FISCUs. As

noted in the proposal and echoed by many of the commenters, NCUA has incorporated the appropriate safeguards into the rule to ensure these transactions are handled in a safe and sound manner. One of the negative commenters incorrectly characterized the proposal as an ''attempt by the credit union industry to exceed its statutory, maximum borrowing authority.'' As noted in the proposal, the statutory limitation applies only to FCUs.

C. Final Amendments

New Sections 701.20 and 741.221—Suretyship and Guaranty

The final rule is identical to the proposal. Section 701.20 recognizes that an FCU, as part of its incidental powers, may act as a guarantor or surety on behalf of a member. 12 U.S.C. 1757(17). Acting as a guarantor or surety on behalf of an FCU member meets the definition of an incidental power because it: Is convenient or useful to an FCU in extending credit to its members; is a logical extension of an FCU's authority to make loans to its members and to provide letters of credit on behalf of members; and involves risks that are similar in nature to the risks involved in an FCU's lending activity. 12 CFR 721.2.

The final rule defines suretyship, guaranty agreements, and principal and includes three requirements designed to ensure the safety and soundness of surety and guaranty agreements. The Board has the same safety and soundness concerns for FISCUs authorized under state law to enter into surety and guaranty agreements as it does for FCUs. Accordingly, the requirements will apply to FISCUs as provided in § 741.220. The requirements are modeled after the requirements in the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) rules on guaranty and suretyship. 12 CFR 7.1017 and 560.60.

The first two requirements are substantially similar to the requirements in the OTS rule. The first requires that the obligation under the agreement be limited to a fixed amount and limited in duration. Without a requirement to limit the amount and duration of the agreement, an FCU may take on more risk than it anticipated in the agreement.

The second provision requires that an FCU's performance under the agreement create a loan that is permissible under applicable law because the nature of a surety or guaranty agreement is a loan. The FCU is lending its credit and, in effect, is lending to its member. An FCU may not use a surety or guaranty agreement as a mechanism to avoid the applicable regulatory requirements for loans. These regulatory requirements are in place to ensure the safety and soundness of the transactions. For example, if an FCU will be a surety or guarantor for a member's obligation for a business loan, it must comply with the member business loan requirements. 12 CFR part 723.

This provision also highlights that an FCU must treat its obligation under the agreement as a contractual commitment to advance funds to the principal under the loans-to-one-borrower limits and loans to insider restrictions. 12 CFR 560.60(b)(3), 701.21(c)(5), (d) and 723.8. Again, these requirements are in place to ensure the safety and soundness of the transaction and should not be circumvented through the use of a surety or guaranty agreement.

The third provision addresses collateral requirements and parallels requirements in the OCC and OTS rules. Depending on the nature of the collateral, an FCU must have collateral equal to 100 or 110 percent of the obligation. The 100 percent collateral category includes cash, obligations of the United States or its agencies, obligations fully guaranteed by the United States or its agencies as to principal and interest, and notes, drafts, bills of exchange, and bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank. Because the value of some of these types of collateral can fluctuate, the proposal requires that the collateral have a market value at the close of each business day equal to 100 percent of the FCU's total potential liability.

The 110 percent collateral category includes real estate and marketable securities. If the collateral is real estate, an FCU must establish the value of the collateral by an evaluation or appraisal of the real estate consistent with NCUA's appraisal regulation. 12 CFR 722.3. If the collateral is marketable securities, an FCU must be authorized to invest in the securities and must ensure that the value of the securities is equal to 110 percent of the obligation at all times. To protect against risk of loss, an FCU must perfect its security interest in the collateral.

Section 741.2—Maximum Borrowing Authority

The final rule is identical to the proposal. It allows an FISCU to apply for a waiver from § 741.2 up to the amount permitted under state law or by the state regulator. Prerequisites for a waiver request include that appropriate safeguards must be in place and that either state law permits the higher limit than that specified in the FCU Act for which the FISCU seeks approval, which is verified by the state regulator, or the state regulator has duly approved a higher limit than that allowed under state law. Instances in which it would seem appropriate to seek a waiver could include a situation where, for example, the borrowing has minimal risk associated with it but the FISCU is unable to enter into the transaction because of the regulatory prohibition. Circumstances presenting minimal risk could be, for example, a transaction where the FISCU is acting as a co-borrower with a member and the member has provided collateral sufficient to cover its obligation if the member defaults on the loan. The waiver process will permit regional directors to take into consideration the circumstances of the FISCU, its community, and members, and provide additional flexibility to address particular needs or benefits on a case-by-case basis. The final regulation contemplates that FISCUs wishing to engage in particular transactions, programs or projects, which would otherwise take their borrowings above the regulatory limitation, will have the opportunity to apply for a waiver, which will include a thorough explanation of the business purposes and strategies the FISCU has in place to mitigate risk, so that regional directors may make an informed determination regarding safety and soundness.

To apply for a waiver, an FISCU must submit its request to the appropriate regional director. The request must include a detailed analysis of the safety and soundness implications of the waiver, a proposed aggregate dollar amount or percentage of paid-in and unimpaired capital and surplus limitation, a letter from the state regulator approving the request, and an explanation demonstrating the need for a higher limit. The regional director will approve the waiver request if he or she determines that the proposed borrowing limit will not adversely affect the safety and soundness of the FISCU.

D. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. The rule authorizes FCUs to enter into surety and guaranty agreements and permits FISCUs to request a waiver from the maximum borrowing limitation. It is

unlikely that small credit unions will participate in either of these activities. 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 NCUA Board has determined that the final rule that allows FISCUs to file for a waiver from the borrowing limitations in § 741.2 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 and is awaiting approval and issuance of a new OMB control number (3133–____).

Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it has 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 final rule will apply directly to federally insured state-chartered credit unions. NCUA has determined that the final rule will not have a substantial direct effect 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 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

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 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 has determined that this rule is not a major rule for purposes of SBREFA.

E. Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose a minimal regulatory burden. The final rule is understandable and imposes minimum regulatory burden.

List of Subjects

12 CFR Part 701

Credit unions.

12 CFR Part 741

Credit unions, Requirements for insurance.

By the National Credit Union Administration Board on February 19, 2004.

Becky Baker,

Secretary of the Board.

■ For the reasons set forth in the preamble, the National Credit Union Administration is amending 12 CFR parts 701 and 741 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.

■ 2. Add new § 701.20 to read as follows:

§ 701.20 Suretyship and guaranty.

(a) *Scope.* This section authorizes a federal credit union to enter into a suretyship or guaranty agreement as an incidental powers activity. This section does not apply to the guaranty of public deposits or the assumption of liability for member accounts.

(b) *Definitions.* A *suretyship* binds a federal credit union with its principal to pay or perform an obligation to a third person. Under a *guaranty* agreement, a federal credit union agrees to satisfy the obligation of the principal only if the principal fails to pay or perform. The *principal* is the person primarily liable, for whose performance of his obligation the surety or guarantor has become bound.

(c) *Requirements.* The suretyship or guaranty agreement must be for the benefit of a principal that is a member and is subject to the following conditions:

(1) The federal credit union limits its obligations under the agreement to a fixed dollar amount and a specified duration;

(2) The federal credit union's performance under the agreement creates an authorized loan that complies with the applicable lending regulations, including the limitations on loans to one member or associated members or officials for purposes of §§ 701.21(c)(5), (d); 723.2 and 723.8; and

(3) The federal credit union obtains a segregated deposit from the member that is sufficient in amount to cover the federal credit union's total potential liability.

(d) *Collateral.* A segregated deposit under this section includes collateral:

(1) In which the federal credit union has perfected its security interest (for example, if the collateral is a printed security, the federal credit union must have obtained physical control of the security, and, if the collateral is a book entry security, the federal credit union must have properly recorded its security interest); and

(2) That has a market value, at the close of each business day, equal to 100 percent of the federal credit union's total potential liability and is composed of:

(i) Cash;

(ii) Obligations of the United States or its agencies;

(iii) Obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(iv) Notes, drafts, or bills of exchange or banker's acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(3) That has a market value equal to 110 percent of the federal credit union's total potential liability and is composed of:

(i) Real estate, the value of which is established by a signed appraisal or evaluation in accordance with part 722 of this chapter. In determining the value of the collateral, the federal credit union must factor in the value of any existing senior mortgages, liens or other encumbrances on the property except those held by the principal to the suretyship or guaranty agreement; or

(ii) Marketable securities that the federal credit union is authorized to invest in. The federal credit union must ensure that the value of the security is 110 percent of the obligation at all times during the term of the agreement.

PART 741—REQUIREMENTS FOR INSURANCE

■ 3. The authority citation for part 741 continues to read as follows:

Authority: 12 U.S.C. 1757, 1766(a), and 1781–1790; Pub.L. 101–73.

■ 4. Amend § 741.2 by designating the existing paragraph as (a) and adding new

paragraphs (b), (c) and (d) to read as follows:

§ 741.2 Maximum borrowing authority.

(a) * * *

(b) A federally insured state-chartered credit union may apply to the regional director for a waiver of paragraph (a) of this section up to the amount permitted under the applicable state law or by the state regulator. The waiver request must include:

(1) Written approval from the state regulator;

(2) A detailed analysis of the safety and soundness implications of the proposed waiver;

(3) A proposed aggregate dollar amount or percentage of paid-in and unimpaired capital and surplus limitation; and

(4) An explanation demonstrating the need to raise the limit.

(c) The regional director will approve the waiver request if the proposed borrowing limit will not adversely affect the safety and soundness of the federally insured state-chartered credit union.

■ 5. Add new § 741.221 to read as follows:

§ 741.221 Suretyship and guaranty requirements.

Any credit union, which is insured pursuant to Title II of the Act, must adhere to the requirements in § 701.20 of this chapter. State-chartered, NCUSIF-insured credit unions may only enter into suretyship and guaranty agreements to the extent authorized under state law.

[FR Doc. 04–4076 Filed 2–24–04; 8:45 am]

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is updating its rule regarding conversion of insured credit unions to mutual savings banks. This amendment requires a converting credit union to provide additional information in the notice to members of its intent to convert. Specifically, the credit union must disclose any economic benefit a director or senior management official of a converting credit union may receive in connection with the conversion. A converting credit union must also disclose how conversion to a mutual savings bank will affect members' voting rights, and how any subsequent conversion to a stock institution may affect ownership interests. NCUA believes this amendment enhances a member's ability to make informed decisions about the conversion without increasing the regulatory burden for converting credit unions and helps converting credit unions to more fully understand what NCUA expects to be included in the notice to members.

DATES: This final rule is effective March 26, 2004.

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

The Credit Union Membership Access Act (CUMAA) was enacted into law on August 7, 1998. Public Law 105–21. Section 202 of CUMAA amended the provisions of the Federal Credit Union Act (Act) concerning conversion of insured credit unions to mutual savings banks. 12 U.S.C. 1785(b). CUMAA required NCUA to promulgate final rules regarding charter conversions that were: (1) Consistent with CUMAA; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions. NCUA issued rules in compliance with this mandate. 63 FR 65532 (November 27, 1998); 64 FR 28733 (May 27, 1999).

In the approximately five years since NCUA first amended Part 708a to comply with CUMAA, NCUA has grown concerned that credit union members may not fully appreciate the effect the conversion may have on their ownership interests in the credit union and voting power in the mutual savings bank. Accordingly, NCUA issued a proposed rule in September 2003 to require a converting credit union to disclose additional information to its members to better educate them regarding the conversion. 68 FR 56589 (October 1, 2003).

B. Discussion

There are increasing indications that a high percentage of credit unions that convert to mutual savings banks have or will undertake a second conversion to become a stock institution. While it is certainly within the rights of the credit union membership to exercise their right to convert and change the structure of the institution, converting credit unions generally do not adequately discuss in the notice to credit union members the likelihood and ramifications of a second conversion to a stock institution.

While state laws may vary, under the Office of Thrift Supervision's regulations, there is no minimum waiting period for a newly chartered federal mutual savings bank to convert to a stock institution. As a result, it is possible for a credit union that converts to a federal mutual savings bank to attempt to convert to a stock institution in as little as two years. In most cases, a conversion from a mutual savings bank to a stock institution will result in a loss of ownership interest for the vast majority of members because they do not purchase stock, while most officers and directors do obtain stock in the newly created stock institution. While members and officials generally have the same opportunity to purchase stock at an initial public offering, officials also obtain stock through other methods such as employee stock ownership plans, restricted stock awards and stock options. These opportunities, which are not available to the general membership, have in the past been little understood and inadequately explained to the members.

While CUMAA provides that an insured credit union may convert to a mutual savings bank without the prior approval of NCUA, it also requires NCUA to administer the member vote on conversion and review the methods and procedures by which the vote is taken. This is reflected in NCUA's conversion rule. The rule requires a converting credit union to provide its members with written notice of its intent to convert. 12 CFR 708a.4. It also specifies that the member notice must adequately describe the purpose and subject matter of the vote on conversion. *Id.* In addition, a converting credit union must notify NCUA of its intent to convert. 12 CFR 708a.5. A credit union must provide for NCUA's review a copy of the member notice, ballot, and all other written materials it has provided or intends to provide to its members in connection with a conversion. *Id.*

A converting credit union has the option of submitting these materials to NCUA before it begins to distribute them to its members. *Id.* This enables a credit union to obtain NCUA's preliminary determination on the methods and procedures of the member vote based on NCUA's review of the written materials. A credit union can then decide whether to move forward with the often expensive, labor intensive conversion process with an understanding of NCUA's position.