United States General Accounting Office

GAO

Report to Congressional Committees

August 2003

FEDERAL DEPOSIT INSURANCE ACT

FTC Best Among Candidates to Enforce Consumer Protection Provisions

GAO-03-971

GAO

Accountability•Integrity•Reliability

Highlights

Highlights of GAO-03-971, a report to congressional committees.

August 2003

FEDERAL DEPOSIT INSURANCE ACT

FTC Best Among Candidates to Enforce Consumer Protection Provisions

Why GAO Did This Study

This mandated report responds to Congressional concerns that provisions in section 43 of the Federal Deposit Insurance Act (FDI Act) are not being enforced. Since 1991, section 43 has required, among other things, depository institutions lacking federal deposit insurance to conspicuously disclose that deposits in these institutions are not federally insured. GAO's objectives were to (1) determine the current status of the enforcement of provisions in section 43; (2) determine the extent of compliance with each provision and the potential impact on consumers if the provisions were not enforced; and (3) evaluate which federal agency could most effectively enforce the provisions.

What GAO Recommends

GAO is not recommending executive action but identifies matters for Congressional consideration. If Congress determines that federal oversight of section 43 is needed, Congress may wish to consider removing the prohibition in FTC's appropriations against enforcing the provisions. Congress may also wish to consider modifying the section to clarify FTC's jurisdiction and to provide FTC with flexibility in administering these requirements by giving FTC authority to consult with other primary regulators, such as NCUA, or FDIC, or partner with states.

www.gao.gov/cgi-bin/getrpt?GAO-03-971.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov.

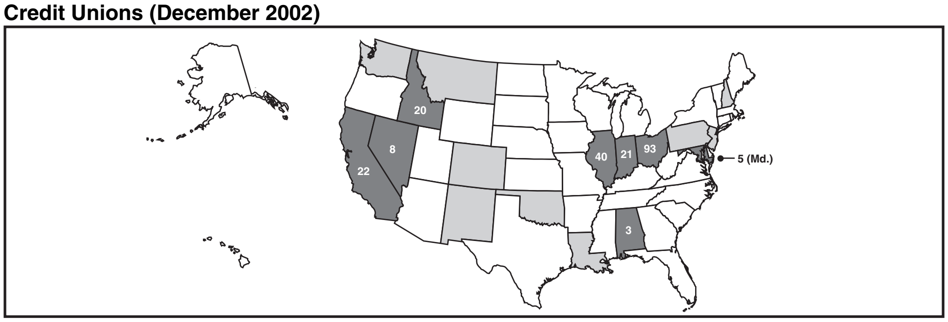
What GAO Found

The Federal Trade Commission (FTC) is responsible for enforcing compliance with the provisions in section 43 of the FDI Act. However, due to a variety of concerns, FTC has requested and appropriators have agreed to prohibit FTC from enforcing these provisions. The National Credit Union Administration (NCUA) and state regulators have imposed some related requirements on credit unions and private deposit insurers. While these requirements are not the same as those in section 43 provisions, they provide some assurances that certain actions contemplated by section 43 are being satisfied.

Some privately insured credit unions GAO visited did not adequately disclose that these institutions were not federally insured; as a result, depositors at these institutions may not be fully informed that their deposits are not federally insured. For example, in unannounced site visits to 57 privately insured credit unions in Alabama, California, Illinois, Indiana, and Ohio, GAO found that required notices were not posted in 37 percent of the locations.

No federal agency is ideally suited to carry out the responsibilities outlined in section 43. Although FTC, NCUA, and the Federal Deposit Insurance Corporation (FDIC) officials generally agreed that consumers should receive information about the insured status of their deposits, they strongly maintained that their respective agencies should not enforce these provisions. NCUA and FDIC officials objected to enforcing these provisions because their agencies have no direct interest in uninsured institutions and their involvement in the enforcement of these requirements could undermine the purposes of the provision. FTC staff raised jurisdictional concerns and asserted that its mission, resources, and practices were ill suited for such a role. GAO believes that clarifying FTC's authority and providing it with additional flexibility in administering these provisions represents the best option to enforce the provisions.

States Permitting Private Deposit Insurance (March 2003) and Number of Privately Insured Credit Unions (December 2002)



States that permit private deposit insurance but do not have privately insured credit unions

States that have credit unions that purchase private deposit insurance

Sources: GAO and state regulators.

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Abbreviations

ASI	American Share Insurance
BIF	Bank Insurance Fund
CPA	Certified Public Accountant
CUIC	Credit Union Insurance Corporation
CUNA	Credit Union National Association
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FTC	Federal Trade Commission
FTC Act	Federal Trade Commission Act
GAO	General Accounting Office
NAFCU	National Association of Federal Credit Unions
NASCUS	National Association of State Credit Union Supervisors
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
RISDIC	Rhode Island Share and Depositors Indemnity Corporation
SAIF	Savings Association Insurance Fund
SEC	Securities and Exchange Commission
TISA	Truth in Savings Act

United States General Accounting Office
Washington, DC 20548

August 20, 2003

Congressional Committees:

After financial crises in the 1980s caused record losses in federal deposit insurance funds, Congress enacted legislation—the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)—that made fundamental changes to federal oversight of depository institutions and added section 43 to the Federal Deposit Insurance Act (FDI Act).[1] Under the section 43 disclosure requirement, depository institutions that lack federal deposit insurance must conspicuously inform consumers that their deposits are not federally insured. The recent conversion of a large federally insured credit union to private deposit insurance has raised concerns whether privately insured credit unions are complying with requirements under this section to ensure that members understand that the federal government does not guarantee their accounts.

In addition to the disclosure requirements, section 43 requires that an institution lacking federal deposit insurance be shut down if the institution's state regulator has not determined its eligibility for federal deposit insurance. The section also requires any provider of private deposit insurance to obtain and distribute an independent annual audit to each depository institution it insures and appropriate supervisory agency of each state in which such an institution receives deposits. In this report, we refer to these requirements as section 43 disclosure, shut-down, and annual audit provisions.

The Federal Trade Commission (FTC or Commission) is statutorily responsible for enforcing compliance with section 43. However, FTC has never taken action to enforce section 43. Rather, FTC has requested that it not enforce these requirements by seeking and obtaining in its

[1] Pub. L. No. 102-242, (1991). Section 43 of FDI Act originally was designated in FDICIA as section 40 of the FDI Act. See Pub. L. No. 101-242 § 151(a). Congress subsequently redesignated section 40 as section 43, which is codified at 12 U.S.C. § 1831t (2000). See Housing and Community Development Act of 1992, Pub. L. No. 102-550 § 1603(b) (2). The federal deposit insurance funds were established to restore and maintain depositors' confidence in the banking system by providing a government guarantee of deposits. This guarantee insures that a person's money on deposit with an insured institution, within certain limits, would be safe and helps negate the need for depositors having to assess the financial condition of their financial institution.

appropriations authority a prohibition against spending appropriated funds to carry out these provisions. As a result, no federal entity is enforcing compliance with section 43.

This report responds to Congressional concerns that section 43 provisions are not being enforced. Specifically, the Conference Report accompanying the Fiscal Year 2003 Consolidated Appropriations Act mandated that we (1) determine the current status of enforcement of these requirements; (2) determine the extent of compliance with each requirement—disclosure, shut down, and annual audit—and the potential impact on consumers if these requirements are not enforced; and (3) evaluate which federal agency could most effectively enforce section 43.[2]

As agreed with committee staff, we limited our assessment of "depository institutions lacking federal deposit insurance" to state-chartered credit unions that purchase private primary deposit insurance.[3] To determine the current status of enforcement of section 43 requirements, and whether other laws or rules impose requirements similar to those of section 43, we interviewed and reviewed available documentation from FTC staff and officials from the National Credit Union Administration (NCUA), the Federal Deposit Insurance Corporation (FDIC), and American Share Insurance (ASI)—the remaining provider of nonfederal (private) deposit insurance.[4] We also surveyed the 50 state credit union regulators to determine which states permitted private deposit insurance. We interviewed regulatory officials in Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, New Hampshire, and Ohio, which include those states where credit unions were permitted and chose not to obtain federal depository insurance. To determine the extent of compliance with section 43 and the potential impact on consumers from nonenforcement, we conducted unannounced site visits to 57 locations of privately insured institutions in Alabama, California, Illinois, Indiana, and Ohio. The purpose

[2] Conference Report to accompany the House Joint Resolution 2, Fiscal Year 2003 Consolidated Appropriations Resolution, Enforcement of section 151 of FDICIA.

[3] Credit unions are nonprofit cooperatives that serve their members by accepting deposits, making loans, and providing various other financial services. Credit unions refer to deposits as "member shares."

[4] As of December 2002, we identified two companies that provided private deposit insurance to credit unions in the 50 states and the District of Columbia—ASI of Ohio and Credit Union Insurance Corporation (CUIC) of Maryland. We met with officials from CUIC; however, we found that this insurer was in the process of dissolution, and therefore, we did not include it in our analysis.

of these visits was to determine whether state-chartered, privately insured credit unions were providing notice that they were not federally insured. The credit union locations were selected based on a convenience sample using state and city location coupled with random selection of main or branch locations within each city. We also discussed the impact of nonenforcement with federal and state regulators noted above. To evaluate which federal agency could most effectively enforce these requirements, we interviewed FTC staff and officials from NCUA, FDIC, and various interested industry groups to discuss their perspectives and obtain their positions on enforcement of section 43 requirements. We also conducted legal research and analysis related to these provisions. We conducted our work in Washington, D.C., Alabama, California, Indiana, Illinois, Maryland, Massachusetts, Ohio, and Virginia between February and August 2003, in accordance with generally accepted government auditing standards. We discuss our scope and methodology in more detail in appendix I.

Results in Brief

Although statutorily responsible for enforcing section 43, FTC, consistent with a prohibition in its appropriations authority, has not prescribed the manner and content of disclosures, provided guidance or undertaken rulemaking to enforce these provisions, or brought any enforcement cases to date. NCUA and state regulators have imposed certain related requirements on state-chartered credit unions and private deposit insurers. While these requirements are not fully comparable to section 43 provisions, they provide some assurance that certain actions contemplated by section 43 are being satisfied. For example, NCUA requires federally insured credit unions seeking to convert to private deposit insurance to notify members that if the conversion is approved, the federal government will not insure deposits.[5] NCUA's requirements, however, are less extensive than the disclosure requirements in section 43.

Compliance with section 43 disclosure, shut-down, and annual audit requirements varied considerably. The most apparent impact on consumers, from the lack of enforcement of these provisions, may result from credit unions not providing adequate disclosures that they are not federally insured.

[5] 12 CFR §§ 708b.201-204, 708b.301, and 708b.302 (2003).

- While state regulators and ASI officials reported monitoring whether privately insured credit unions disclosed that they were not federally insured, we found many privately insured credit unions that we visited did not always make such disclosures. For example, we found that 37 percent (21 of 57) of the locations we visited did not post signage in their lobbies indicating that deposits were not federally insured. As a result, depositors at these institutions may not be adequately informed, as specifically required in section 43, that (1) their deposits are not federally insured or (2) if the institution fails, the federal government does not guarantee that they will get back their money.

- Section 43 prohibits depository institutions lacking federal deposit insurance from engaging in interstate commerce unless the institution's state regulator has determined the institution's eligibility for federal deposit insurance. It appears that privately insured credit unions have not obtained this determination from their state regulators. However, this determination may not be a meaningful protection for consumers. Because this is a one-time requirement, this determination does not ensure that the institution will remain eligible for federal deposit insurance. Also, when an institution converts from federal deposit insurance to private deposit insurance, such an eligibility determination would be redundant because the institution had been eligible for federal deposit insurance before it became privately insured. State regulators also reported that although they had not made these explicit determinations, they imposed safety and soundness standards for credit unions lacking federal deposit insurance that the regulators believed generally satisfied the criteria for federal deposit insurance. Although the states' examination standards are similar, NCUA's decision to insure a credit union is done on a case-by-case basis and NCUA officials consider other factors when determining eligibility. ASI officials also told us that they rigorously monitor the safety and soundness of their insured institutions. Given the related actions undertaken to help ensure the health of privately insured credit unions, the effect on consumers from the lack of enforcement of this provision may be negligible.

- The remaining private deposit insurer, ASI, has complied with section 43 audit requirements and, as a result, state regulators and the management of privately insured credit unions have had the opportunity to become informed about the financial condition of this private deposit insurer. Section 43 requires private deposit insurers to obtain an annual audit that includes a determination of whether the insurer follows generally accepted accounting principles and to distribute the audit. We found that the audits obtained by ASI for 1999, 2000, 2001, and 2002 complied with this federal requirement. Also, appropriate state regulators and the management of some privately insured credit unions told us that ASI had provided the audits in accordance with the requirement. Since the private deposit insurer has obtained and distributed the audit as required, it appears consumers suffered no negative impact from the nonenforcement of this provision.

In evaluating which agency should enforce section 43 provisions, we found the responsibilities outlined in these provisions did not fall ideally within any single agency's jurisdiction. FTC staff and officials from NCUA and FDIC told us that their respective agencies should not be charged with administering section 43. Officials from both NCUA and FDIC objected to having regulatory responsibility under section 43 because their agencies have no direct interest in the operations of institutions they do not insure. They maintained that requiring their agencies to administer section 43 could undermine the purposes of the provision and, potentially, the credit union system, by closely associating private deposit insurance with federal deposit insurance. Because NCUA administers the federal deposit insurance fund for credit unions, it is believed that if NCUA were to prescribe disclosure requirements or enforce the shut-down or audit provisions under section 43, it would create a regulatory conflict of interest that could result in NCUA's regulatory decisions being questioned or challenged. FTC staff raised jurisdictional concerns and offered several reasons why the Commission's mission, resources, and practices are ill suited for such a role. Those reasons reflect FTC's perception about its authority under section 43 and how the section should be administered, as well as how the Commission carries out its consumer protection mission. Based on our review of the concerns raised by FTC, NCUA and FDIC, we believe FTC is best among these candidates to be the primary agency responsible for implementing section 43. However, clarifying FTC's authority and providing it with additional flexibility in administering these provisions could better ensure effective enforcement of these provisions.

This report contains matters for Congressional consideration to remove obstacles and provide additional flexibility in enforcing the consumer protections intended under section 43. If Congress determines that federal oversight of section 43 is needed, Congress may wish to consider removing the prohibition in FTC's appropriations against enforcing the provisions. Congress may also wish to consider modifying the section to clarify FTC's jurisdiction and providing FTC flexibility in administering these requirements by giving FTC authority to consult with other primary regulators, such as NCUA or FDIC, or partner with states.

We received oral comments on a draft of this report from FDIC and written comments from NCUA and FTC. FDIC and NCUA generally agreed with the report's conclusions. FTC disagreed with the report's conclusions and matters for congressional consideration and stated that it was not able to implement and enforce these provisions. The comments are discussed in greater detail at the end of this letter, and the written comments are reprinted as appendixes III and IV.

Background

Under federal and state laws, all federally chartered depository institutions and the vast majority of state-chartered institutions are required to have federal deposit insurance. The federal deposit insurance funds were established to restore and maintain depositors' confidence in the banking system by providing a government guarantee of deposits. This guarantee insures that a person's money on deposit with an insured institution, within certain limits, would be safe and helps negate the need for depositors having to assess the financial condition of their financial institution. FDIC administers the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). Deposit accounts maintained at banks and thrifts generally are federally insured, regardless of who charters the institution. Similarly, credit unions that are federally chartered must be federally insured by the National Credit Union Share Insurance Fund (NCUSIF), which is administered by NCUA.[6] Almost all (98 percent) credit unions are federally insured. As of December 2002, 9,688 credit unions were federally insured, with about 81 million members and $483 billion in deposits.[7]

However, in our survey of the 50 state regulators, we found that not all states require federal deposit insurance for credit unions they charter.[8] As of December 2002, 212 credit unions—about 2 percent of all credit unions—chose to purchase private deposit insurance. These privately

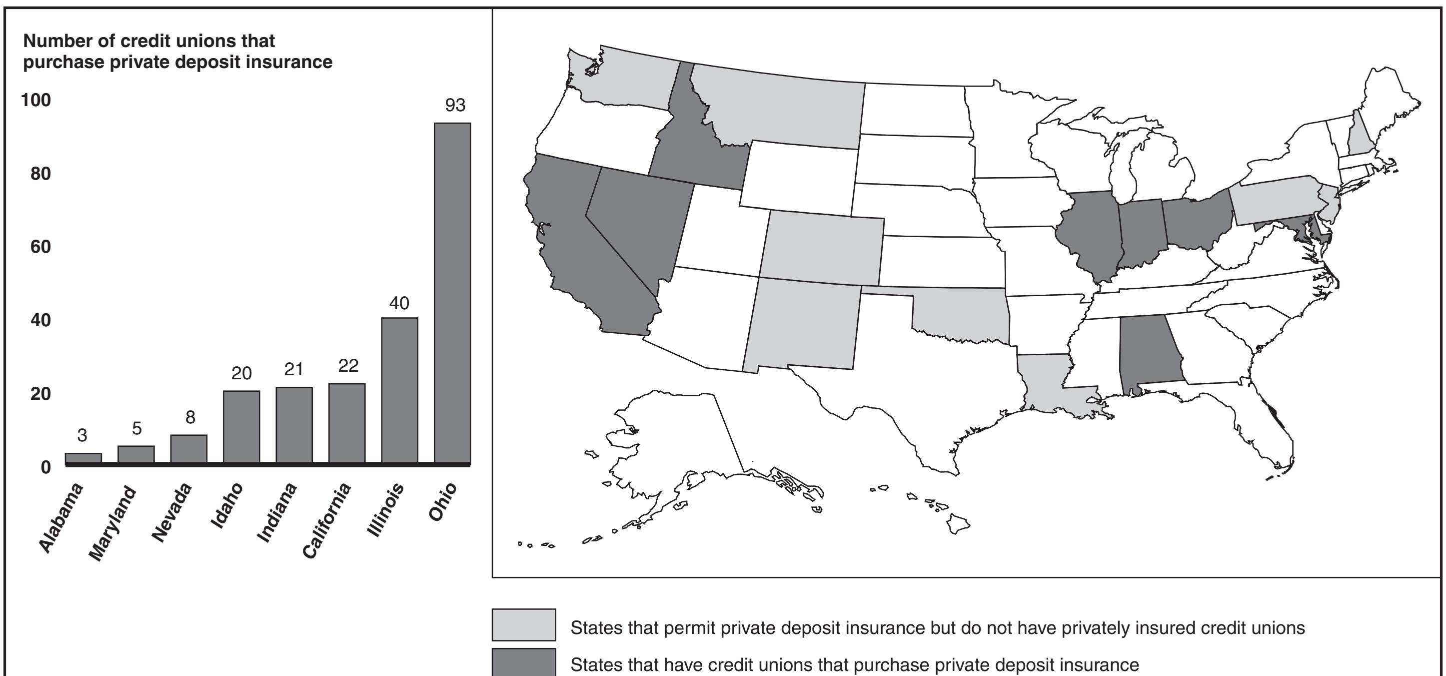
[6] Credit unions are nonprofit cooperatives that serve their members by accepting deposits, making loans, and providing various other financial services. Generally, primary deposit insurance is mandatory for all depository institutions and covers members' deposits up to a specified amount. Excess deposit insurance is optional coverage above the amount provided by primary deposit insurance. NCUSIF provides primary deposit insurance up to $100,000 per member; while ASI provides primary deposit insurance up to $250,000 per account and excess deposit insurance.

[7] Of these federally insured credit unions, the federal government chartered about 60 percent, while about 40 percent were chartered by their respective states.

[8] Through our discussions with state regulators, we identified two uninsured credit unions, one was located in Idaho and the other was located in New Hampshire.

insured credit unions are located in eight states and had about 1.1 million members with deposits totaling about $10.8 billion, as of December 2002—a little over 1 percent of all credit union members and 2 percent of all credit union deposits. We identified nine additional states that could permit credit unions to purchase private deposit insurance through our survey of 50 state regulators and subsequent discussions with state regulators. Figure 1 illustrates the states that permit or could permit private deposit insurance as of March 2003 and the number of privately insured credit unions as of December 2002.

Figure 1: States Permitting Private Deposit Insurance (March 2003) and Number of Privately Insured Credit Unions (December 2002)



Sources: GAO and state regulators.

The number of privately insured credit unions and private deposit insurers has declined significantly since 1990. In 1990, 1,462 credit unions in 23 states purchased private deposit insurance from 10 different nonfederal, private insurers. At that time, deposits at these credit unions totaled $18.6 billion—73 percent more than the total of privately insured deposits as of December 2002. Shortly after the failure of Rhode Island Share and Depositors Indemnity Corporation (RISDIC), a private deposit insurer in

Rhode Island in 1991, almost half of all privately insured credit unions converted to federal deposit insurance voluntarily or by state mandate.[9] As a result of the conversions from private to federal deposit insurance, most private deposit insurers have gone out of business due to the loss of their membership since 1990 and only one company—ASI—currently offers private primary deposit insurance.

ASI has a statutory charter granted by the State of Ohio.[10] ASI is licensed by the Ohio Superintendent of Insurance and is subject to oversight by that department and Ohio's Superintendent of Credit Unions. Unlike federal deposit insurance, which is backed by the full faith and credit of the United States, ASI's insurance fund is not backed by the full faith and credit of any governmental entity. Also, in contrast to federal deposit insurance, which covers up to $100,000 in an insured account, the coverage amount provided by ASI is subject to a $250,000 statutory cap in Ohio law.

Depository institutions lacking federal deposit insurance—privately insured credit unions—do not directly present a risk to the respective federal deposit insurance funds and do not pay for participation in those funds. Accordingly, they are not subject to supervision by the agencies that administer those funds. The Federal Credit Union Act contains criteria for credit unions applying for federal deposit insurance from NCUA and requires NCUA to consider a list of factors before approving an application to become federally insured.[11] For example, NCUA must assess the credit union's financial condition, the adequacy of reserves, the fitness of management, and the convenience and needs of the members to be served by the institution. To continue to be eligible for federal deposit insurance, credit unions must continue to comply with NCUA regulations

[9] Several factors precipitated the closure of RISDIC in 1991. For example, weaknesses existed in the Rhode Island bank regulator's and RISDIC's oversight of institutions. Furthermore, some of the institutions insured by RISDIC engaged in high-risk activities. In 1991, RISDIC depleted its reserves because of the failure of one institution. As a result, runs occurred at several other institutions insured by RISDIC; and it was not able to meet its insurance obligations and was forced to call in a conservator. The Governor of Rhode Island closed all institutions insured by RISDIC and required institutions to purchase federal deposit insurance.

[10] See Ohio Rev. Code Ann. Ch. 1761 (2002).

[11] 12 U.S.C. § 1781(b).

for measures of net worth, prompt corrective action requirements, and rules governing investment and deposit activities.[12]

Section 43 Requirements

Section 43 imposes requirements on depository institutions lacking federal deposit insurance and private deposit insurers and assigns FTC with the responsibility for enforcing compliance with these provisions. Specifically, section 43 requires depository institutions lacking federal deposit insurance to

- Include conspicuously on all periodic account statements, signature cards, passbooks, certificates of deposits, or similar instruments evidencing a deposit, a notice that the institution is not federally insured and that if the institution fails, the federal government does not guarantee that depositors will get back their money;
- Include conspicuously in all advertising and where deposits are normally received a notice that the institution is not federally insured; and
- Obtain a written acknowledgement from depositors that the institution is not federally insured and that if the institution fails, the federal government does not guarantee that the depositor will get back their money. [13]

In addition, section 43 prohibits institutions lacking federal deposit insurance from engaging in interstate commerce unless the appropriate supervisor of the institution's charter state has determined that the institution meets all eligibility requirements for federal deposit insurance. This prohibition is referred to as the "shut-down" provision.[14]

[12] See, *e.g.*, 12 U.S.C. § 1786(e); 12 C.F.R. Parts 702 and 703.

[13] 12 U.S.C. § 1831t (b). Section 43 provides an exception from these requirements. Specifically, FTC may, by regulation or order, make exceptions for any depository institution that, within the United States, does not receive initial deposits of less than $100,000 from individuals who are citizens or residents of the United States, other than money received in connection with any draft or similar instrument issued to transmit money. Section 43 also provides an alternative to the acknowledgement requirement for depositors who were depositors before June 19, 1994, which allows an institution to send a series of three notices containing the acknowledgment notice if the institution has not obtained a written acknowledgment from such depositors.

[14] 12 U.S.C. § 1831t (e). Section 43 provides that FTC, in consultation with FDIC, may permit an exception to this requirement.

With respect to private deposit insurers, section 43 requires each insurer to

- Obtain an annual audit from an independent auditor using generally accepted auditing standards that includes a determination of whether the private deposit insurer follows generally accepted accounting principles and has set aside sufficient reserves for losses; and

- Distribute copies of the audit report to each depository institution it insures and to the appropriate supervisory agency of each state in which such an institution receives deposits, within specified time frames.[15]

With respect to FTC, section 43

- Requires the Commission to prescribe "the manner and content of disclosure required under the section" in order to "ensure that current and prospective customers understand the risks involved in forgoing federal deposit insurance;"

- Assigns to FTC the responsibility to enforce compliance with the section under the Federal Trade Commission Act (FTC Act);

- Authorizes FTC to determine that an institution not chartered as a depository institution nonetheless is subject to the section, referred to as the look-alike provision; and

- Authorizes FTC, in consultation with FDIC, to exempt an institution from the shut-down provision.[16]

Since being charged with the responsibility to enforce and implement these requirements, FTC has requested Congress to prohibit it from enforcing these provisions. In response, FTC's appropriation language, since 1993, has contained provisions prohibiting it from using funds to implement these provisions.

FTC has authority to enforce a variety of federal antitrust and consumer protection laws. According to FTC, it works to enhance the smooth

[15] 12 U.S.C. § 1831t (a).

[16] 12 U.S.C. § 1831t(c), (g), (f)(2), and (e)(1), respectively.

operation of the marketplace by eliminating acts or practices that are unfair or deceptive, and its efforts have been directed toward stopping actions that threaten consumers' opportunities to exercise informed choice. The FTC Act charges FTC with responsibility for preventing the use of unfair methods of competition and unfair or deceptive acts or practices.[17] That act, however, provides that FTC's powers generally do not extend to depository institutions—banks, thrifts, and federal credit unions—which typically are beyond FTC's authority.[18] In addition, one section of the FTC Act has been interpreted to mean that FTC does not have jurisdiction over nonprofit corporations.[19]

NCUA and State Regulators Imposed Related Disclosure and Audit Requirements

Consistent with its appropriations authority prohibiting FTC from enforcing section 43, FTC has not implemented regulations or orders to prescribe the manner and content of required disclosures; to date, FTC has not brought any enforcement cases as a result of the identification of noncompliance with the disclosure, shut-down, and annual audit provisions. As part of this review, we also ascertained whether other laws or rules impose requirements similar to those of section 43. We found that NCUA and state regulators have imposed disclosure and audit requirements on state-chartered credit unions and private deposit insurers that, while not comparable to section 43 requirements, help achieve the objectives of section 43.

For example, NCUA imposes notification requirements on federally insured credit unions seeking to convert to private deposit insurance. NCUA requires these credit unions to notify their members, in a disclosure, that if the conversion were approved, the federal government would not insure deposits. Specifically, under the Federal Credit Union Act, if a federally insured credit union terminates federal deposit insurance or converts to nonfederal (private) insurance, the institution must give its members "prompt and reasonable notice" that the institution has ceased to be federally insured.[20] NCUA rules implement these provisions by prescribing language to be used in (1) the notices of the credit union's proposal to terminate federal deposit insurance or convert to nonfederal (private) insurance, (2) an acknowledgement on the voting

[17] 15 U.S.C. § 45 (2000).

[18] *Id.*; see also 15 U.S.C. § 57a(f)(3), a(f)(4).

[19] 15 U.S.C. § 44. This provision is discussed later in this report.

[20] 12 USC § 1786(c), (d).

ballot of the member's understanding that federal deposit insurance will terminate, and (3) the notice of the termination or conversion.[21] Under NCUA's rules, the prescribed language is to include a statement apprising members that their accounts no longer would be federally insured. Other language to be included on the notice of a proposal to convert to private deposit insurance and on the related voting ballot is to state that NCUA's insurance is backed by the full faith and credit of the United States and that the private deposit insurance is not backed by the full faith and credit of the United States.[22]

While NCUA's disclosure requirements provide some assurance that current members of credit unions converting to private deposit insurance are notified of the lack of federal deposit insurance coverage, these NCUA regulations do not apply to institutions that never were federally insured. In addition, disclosures contained in NCUA's required notifications are not as extensive as disclosures required under section 43. NCUA disclosure pertains to a specific event (termination of insurance or conversion to private deposit insurance) and is provided only to those individuals who are members of the credit union at the time of the event. Section 43, on the other hand, requires disclosure to all members who are depositors, including those individuals who become members after the credit union has terminated federal deposit insurance. Section 43 also requires that depositors acknowledge in writing that the institution is not federally insured and that no federal guarantee exists.[23] In addition, under section 43, an institution's lack of federal deposit insurance must be stated, on an ongoing basis, in periodic account statements, signature cards, passbooks and instruments evidencing a deposit, and in advertising and displays.

In our review of Ohio's law, we noted that Ohio imposes certain disclosure requirements about the insured status of depository accounts. Ohio law requires credit union brochures that include the name of the private deposit insurer to also include a specific notice: "Members Accounts Are

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[21] 12 C.F.R. §§ 708b.201-204, 708b.301, and 708b.302. The FCU Act requires a membership vote approving conversion from federal to private deposit insurance.

[22] We reviewed six recent conversions to private deposit insurance and found that, prior to NCUA's termination of the credit union's federal deposit insurance, these credit unions had generally complied with NCUA's notification requirements for conversion.

[23] As noted previously, this requirement is subject to an exception, which permits an institution to send a series of three notices to those depositors who were depositors before June 19, 1994, and have not signed an acknowledgement.

Not Insured or Guaranteed by Any Government or Government-sponsored Agency."[24] The requirements we reviewed, like Ohio law, typically do not require disclosure of the same information or in the same manner as is required by section 43.

Ohio also imposes several requirements on the remaining private deposit insurer, ASI.[25] For example, Ohio requires ASI to submit annual audited financial statements and quarterly unaudited financial statements to Ohio regulators.[26] While this annual audit requirement is similar to the section 43 provision, Ohio does not require private deposit insurers to distribute this information to the appropriate supervisory agency of each state in which it insures deposits nor to depository institutions in which it insures deposits.

Compliance with Section 43 Provisions Varied; Potential Impact on Consumers Most Evident in Credit Union Noncompliance with Disclosure Requirements

Compliance with section 43 disclosure, shut-down, and annual audit requirements varied considerably. The most likely impact on consumers from the lack of enforcement of these provisions may result from credit unions not providing adequate disclosures about not being federally insured. We found that many privately insured credit unions have not always complied with the disclosure requirements in section 43 that are designed to notify consumers that the deposits in these institutions are not federally insured. While state regulators and ASI officials reported monitoring whether privately insured credit unions disclosed the lack of federal deposit insurance to depositors, we found that these actions varied and did not ensure that all credit unions complied with required disclosures. As a result, depositors at some privately insured credit unions may not be adequately informed that deposits at these institutions are not federally insured. Regarding the shut-down provision, state regulators reported to us that they did not make explicit determinations of

[24] During our site visits in Ohio, we visited 16 credit unions; eight credit unions had materials that mentioned ASI. Of the 25 pieces of material we collected at these credit unions, we found that 17 had not complied with Ohio law.

[25] The Ohio Department of Financial Institutions and the Department of Insurance dually regulate ASI. See Ohio Rev. Code Ann. Ch. 1761 (2002).

[26] Ohio law also requires ASI to provide copies of written communication with regulatory significance to Ohio regulators and to obtain the opinion of an actuary attesting to the adecuacy of loss reserves established. According to officials from the Ohio Department of Financial Institutions and the Department of Insurance, ASI has complied with the requirements and regulators have never needed to take corrective actions against ASI or not permitted ASI to do business in Ohio.

insurability but we found that such a determination may not provide a meaningful protection for consumers. The remaining private deposit insurer complied with the annual audit requirements, making it possible for state regulators and member credit unions to become informed about the insurer's financial condition. Therefore, the lack of enforcement of this provision appears to have had no direct effect on consumers.

The Lobbies, Materials, and Web Sites of Many Privately Insured Credit Unions Lacked Disclosures as Required under Section 43

Section 43 requires privately insured credit unions to disclose to their members that deposits at these institutions are (1) not federally insured and (2) if the institution fails, the federal government does not guarantee that depositors will get back their money. Specifically, these institutions are required to disclose this information at places where deposits are normally received (lobbies) and on signature cards, and on instruments evidencing a deposit (deposit slips). Advertising (brochures and newsletters) must also contain the statement that the institutions are not federally insured. We conducted unannounced site visits to 57 locations of privately insured credit unions (49 main and 8 branch locations) in five states—Alabama, California, Illinois, Indiana, and Ohio. On our visits we looked to see whether credit unions lacking federal deposit insurance had disclosed to their members that the institution was not federally insured and that the federal government did not guarantee their deposits. We found that many privately insured credit unions we visited did not conspicuously disclose this information. Specifically, as shown in table 1, 37 percent (21 of 57) of the locations we visited did not conspicuously post signage in the lobby of the credit union.

Credit unions' compliance with this requirement varied by state. For example, six of the 21 sites visited in California—or 29 percent—did not display the required notices, while three of the five sites visited in Alabama—or 60 percent—did not display conspicuous signage in their lobbies.

Table 1: Number and Percent of Credit Unions Visited without Required Signage in Lobby

	Total number of privately insured credit unions	Total sites visited	Sites visited without conspicuous signage located in lobby: Total number	Total percent
Alabama	3	5[a]	3	60
California	22	21[b]	6	29
Illinois	40	10[c]	4	40
Indiana	21	5	2	40
Ohio	93	16	6	38
Total	**179**	**57**	**21**	**37**

Source: GAO.

Notes:

[a]For two credit unions, in addition to conducting a site visit at the main location, we conducted a site visit at a branch location.

[b]For one credit union, in addition to conducting a site visit at the main location, we conducted site visits at three branch locations. For another credit union, in addition to conducting a site visit at the main location, we conducted a site visit at a branch location.

[c]For two credit unions, we only conducted a site visit at a branch location.

On our visits to these credit unions, we also obtained other available credit union materials (brochures, membership agreements, signature cards, deposit slips, and newsletters) that did not include language to notify consumers that the credit union was not federally insured—as required by section 43. Overall, 134 of the 227 pieces of material we obtained from 57 credit union locations—or 59 percent—did not include specified language. Specifically, 20 of 32 signature cards we obtained from 31 credit unions, and 19 of 20 deposit slips we obtained from 18 credit unions did not include specified language (see table 2).

Table 2: Number and Percent of Credit Union Materials Reviewed without Required Disclosures

Type of document	Total number reviewed	Materials without required disclosures: Total number	Materials without required disclosures: Total percent
Brochures:			
Membership at credit union	49	23	47
Checking accounts	24	13	54
Savings accounts	22	7	32
Investment accounts	34	27	79
Membership agreements	19	11	58
Signature cards	32	20	62
Deposit slips	20	19	95
Newsletters	27	14	52
Total	**227**	**134**	**59**

Source: GAO.

As part of our review, we also reviewed 78 Web sites of privately insured credit unions and found that many credit union Web sites were not fully compliant with section 43 disclosure requirements. For example, 39 of the 78 sites had not included language to notify consumers that the credit union was not federally insured. Specifically, in six of the eight states we reviewed, more than half of the Web sites identified and analyzed in each state were not compliant (see table 3).

Table 3: Number and Percent of Web Sites Reviewed without Required Disclosures

	Total number of privately insured credit unions	Number of Web sites identified and analyzed	Web sites without required disclosures: Total number	Web sites without required disclosures: Total percent
Alabama	3	2	0	0
California	22	18	3	17
Idaho	20	7	5	71
Illinois	40	15	8	53
Indiana	21	7	4	57
Maryland	5	2	2	100
Nevada	8	4	3	75
Ohio	93	23	14	61
Total	**212**	**78**	**39**	**50**

Source: GAO.

While these results were not obtained from a statistically valid sample that would allow us to project the extent of compliance to all privately insured credit unions, these findings are robust enough, both in the aggregate and within each state, to raise concern about the lack of required disclosures by privately insured credit unions.

Monitoring Efforts over Disclosures by Privately Insured Credit Unions Varied

The extent to which state regulators and ASI officials monitored whether privately insured credit unions disclosed the lack of federal deposit insurance to depositors varied. State regulators in Alabama, California, Idaho, Indiana, Maryland, Nevada, and Ohio reported that during state examinations of credit unions, their examiners looked to see whether privately insured credit unions disclosed the lack of federal deposit insurance to depositors. However, according to these state regulators, state examination procedures did not include specific guidance on how to determine if credit unions were compliant with disclosure requirements in section 43. Also, state regulators reported that although they monitored disclosures at privately insured credit unions, they generally had not enforced these requirements. Since we observed poor compliance with section 43 disclosure requirements in our site visits, oversight by state regulators has not provided sufficient assurance that privately insured credit unions are adequately disclosing that their institutions are not federally insured.

ASI officials told us that they had developed materials that explained the disclosure requirements of section 43 to assist credit unions it insured to comply with these requirements. ASI officials reported that they provide these materials to credit unions when they convert to private deposit insurance and to other credit unions that requested these materials. Among other things, these materials inform credit unions of the specific disclosure requirements and include samples of on-premise signage. However, our review of ASI's samples for on-premise signage found that not all samples included language to notify consumers that the credit union was not federally insured.

ASI's on-site audit program included specific guidance on how to determine if credit unions were compliant with disclosure requirements in section 43. In our review of two ASI examination files, we observed that ASI officials had noted that these two credit unions in Nevada had not included language on credit union materials, such as signature cards, stating that the institution is not federally insured and that if the institution fails, the federal government does not guarantee that depositors will get back their money. In our follow-up discussions with ASI management, they indicated that while ASI officials made some notes regarding compliance when conducting on-site exams—as in the examination files on the Nevada credit unions—they did not take action to enforce these federal requirements.

Credit Unions Do Not Appear to Have Obtained State Determinations of Insurability, but Impact on Consumers May Be Limited

The shut-down provision of section 43 prohibits depository institutions lacking federal deposit insurance from engaging in interstate commerce unless the institution's state regulator has determined the institution's eligibility for federal deposit insurance.[27] To be eligible for federal deposit insurance, NCUA must, among other things, assess the credit union's financial condition, the adequacy of reserves, the fitness of management, and the convenience and needs of the members to be served by the institution. It appears that privately insured credit unions have not obtained this determination from their state regulators. One could question, however, whether the states could or should make the determination that institutions meet the standards for federal deposit insurance. Even if the state applied federal deposit insurance eligibility criteria in making the determination for credit unions, the determination

[27] 12 U.S.C. § 1831t(e). Section 43 provides that FTC, in consultation with FDIC, may permit an exception to this requirement.

may not necessarily provide a meaningful protection for consumers; however, other actions were taken to ensure the health of privately insured credit unions.

Section 43 calls for a one-time eligibility determination and does not require an ongoing state assessment of the institutions' compliance with federal deposit insurance eligibility requirements.[28] Because this is a one-time determination, it does not ensure that credit unions would remain eligible for federal deposit insurance. Other circumstances also indicate that consumers might not benefit from the eligibility determination. For example, when an institution converts from federal deposit insurance to private deposit insurance, such an eligibility determination would be redundant because the institution had been eligible for federal deposit insurance before it became privately insured.[29] According to ASI, between 1992 and 2002, 27 credit unions converted from federal to private deposit insurance.[30] In these cases, it would be doubtful that an eligibility determination would benefit consumers.

State regulators also told us that while they had not made explicit determinations that these privately insured credit unions had met eligibility requirements for federal deposit insurance, they imposed safety and soundness standards on credit unions lacking federal deposit insurance, which the regulators believed generally satisfied the criteria for

[28] The language of section 43 indicates that only a single determination is required. The section requires an institution to shut down "unless the appropriate supervisor of the State in which the institution is chartered has determined that the institution meets all eligibility requirements for Federal deposit insurance…." 12 U.S.C. § 1831t(e)(1).

[29] Since 1990, the number of credit unions converting from federal to private deposit insurance and private to federal deposit insurance—in states that permit private deposit insurance—has been comparable. Since 1990, 26 credit unions, located in those states that permit private deposit insurance, converted from private to federal deposit insurance. Generally, credit unions that converted from federal to private deposit insurance since 1990 are larger than credit unions that switched from private to federal deposit insurance during the same period. Specifically, 10 credit unions that converted to private deposit insurance currently each have deposits between $100 and $500 million. By comparison, 20 credit unions that converted to federal deposit insurance currently each have total deposits of less than $50 million.

[30] Most (25 of 27) of these conversions occurred since 1997. With respect to credit unions, private deposit insurance predates federal deposit insurance. In 1970, Congress created NCUSIF. Since 1994, ASI has provided insurance for two newly chartered credit unions and for one credit union that formerly had been uninsured.

federal deposit insurance.[31] For example, these regulators reported that they applied the same examination and supervision process to all state-chartered credit unions—regardless of deposit insurance status. In addition, these states had adopted NCUA's examination program and their examiners had received training from NCUA. However, implementation of NCUA's examination program does not fully insure that those institutions meet all federal deposit insurance eligibility standards. For example, besides assessing a credit union's financial condition and the adequacy of its reserves when making insurability determinations, NCUA is also required to factor in membership considerations such as the convenience and needs of the members to be served by the institution.

Some states also had an approval process for credit unions seeking to purchase private deposit insurance. Alabama, Illinois, and Ohio had written guidelines for credit unions seeking to purchase private deposit insurance.[32] The other five states that permitted private deposit insurance did not have written guidelines for credit unions seeking to purchase private deposit insurance, but Idaho, Indiana, and Nevada state regulators noted that they had the authority to "not approve" a credit union's purchase of private deposit insurance.[33]

Additionally, ASI had several strategies in place to oversee the credit unions it insured. Specifically, ASI regularly conducted off-site monitoring and conducted on-site examinations of privately insured credit unions at least every 3 years. It also reviewed state examination reports for the credit unions it insured, and imposed strict audit requirements. For example, ASI required an annual CPA audit for credit unions with $20 million or more in assets, while NCUA only required the annual audit for credit unions with more than $500 million in assets. ASI also had targeted its monitoring of its largest and smallest credit unions. For larger credit unions, those with more than 10 percent of ASI's total insured shares, ASI planned to conduct semiannual, on-site examinations and monthly and

[31] The eligibility standards for federal credit union insurance are set forth in the Federal Credit Union Act, 12 U.S.C. § 1781, and in NCUA regulations, 12 C.F.R. Part 741.

[32] For example, credit unions in Alabama seeking to purchase private deposit insurance must meet the state's minimum safety and soundness standards, including measures of the credit union's total capital and asset quality.

[33] For example, regulators in Idaho stated that if the credit union did not meet state requirements for safety and soundness, they would not approve a credit union's purchase of private deposit insurance.

quarterly off-site monitoring, including a review of audits and financial statements.[34] In January 2003, five credit unions comprising about 40 percent of ASI's total assets qualified for this special monitoring.[35] In January 2003, ASI also began a monitoring strategy intended to increase its oversight of smaller credit unions.[36] First, ASI assigned a risk level to credit unions it insured (low, moderate, or high) and then used this assessment to determine the extent and frequency of oversight at the credit union.[37] In January 2003, ASI had determined that 98 credit unions qualified for this monitoring, with shares from the largest of these credit unions totaling about $23 million.

Since the above actions were taken to ensure the health of privately insured credit unions, the effect on consumers from the lack of enforcement of this provision may be negligible.

Remaining Private Deposit Insurer Complied with Federal Audit Requirements

The remaining private deposit insurer has complied with the audit requirements under section 43, which requires private deposit insurers to obtain an annual audit and provide it to state regulators and the management of privately insured credit unions within certain time frames.[38] Among other things, the audit must be conducted by an independent auditor using generally accepted auditing standards and include a determination of whether the insurer follows generally accepted accounting principles and has set aside sufficient reserves for losses. The private deposit insurer must provide a copy of the report to each depository institution it insures not later than 14 days after the audit is completed. Also, the private insurer must provide a copy of the report to

[34] Generally, ASI implemented this special monitoring plan because it began to provide insurance to a very large credit union, with over $2 billion in total assets.

[35] As of June 2003, the total shares of these credit unions ranged from $297.6 million to $2.5 billion. Though the plan targeted only ASI's five largest credit unions, ASI may increase the number of monitored credit unions at any time so that it continually reviews at least 25 percent of its total assets.

[36] Generally, ASI implemented this special monitoring plan due to larger-than-expected losses at a small credit union in 2002.

[37] For example, the extent of oversight could require conducting face-to-face interviews with the chair of the supervisory audit committee, confirming that checks over $1000 have cleared, and verifying the value of loans, investments, and share accounts with credit union members in writing or over the telephone.

[38] 12 U.S.C. § 1831t(a).

the "appropriate supervisory agency" of each state in which such an institution receives deposits not later than 7 days after the audit is completed.[39]

We found that the audits obtained by ASI for 1999, 2000, 2001, and 2002 complied with this federal requirement. Specifically, these audits noted that the reviewed consolidated financial statements presented fairly, in all material respects, ASI's financial position and the results of their operations and cash flows for the years reviewed in conformance with accounting principles generally accepted in the United States. Further, appropriate state regulators and the management of some privately insured credit unions told us that ASI had provided them copies of the annual audits in accordance with the requirement. Since the private deposit insurer has obtained and distributed the audit as required, it has given state regulators and the management of privately insured credit unions the opportunity to become informed about the financial condition of the private deposit insurer. This could help ensure the safety and soundness of ASI—which, in turn, protects consumers. It appears consumers have suffered no negative impact from the nonenforcement of this provision.

Although There Is No Ideal Regulator to Enforce Section 43, FTC Is Best among Candidates to Enforce Provisions

In evaluating which agency should enforce section 43, we did not find an agency that was ideally suited to carry out the responsibilities set forth in the provision. Although FTC, NCUA, and FDIC officials generally agreed that consumers should receive proper notification about the insured status of their deposits, they maintained that their respective agencies should not be charged with responsibility for implementing and enforcing section 43. NCUA and FDIC oppose having any responsibilities under section 43 because such a role would result in a regulatory conflict of interest and would be inconsistent with their missions and the section's purpose. Credit union industry representatives believe that FTC is the appropriate federal agency to enforce section 43. FTC staff stated that questions about the Commission's authority under section 43 and the Commission's lack of expertise to administer the section justify removing FTC from any responsibilities under the provision. The staff asserted that other federal agencies are more qualified to carry out the section. Based on our review of these concerns, we believe FTC is the best among these candidates to

[39] Since ASI is a mutual, member-owned organization and is not publicly traded, ASI is not required to make the same public filings that are required for publicly traded firms.

enforce these provisions; however, clarifying FTC's authority and providing it with additional flexibility in administering these provisions could better ensure effective enforcement of these provisions.

NCUA and FDIC Oppose Having Enforcement Responsibility under Section 43

NCUA has taken the position that it should not be responsible for enforcing section 43. In our discussions with NCUA officials, they offered several reasons why NCUA should not be charged with enforcing section 43. They expressed concern that placing the responsibility with NCUA would closely identify NCUA with uninsured credit unions and, in turn, create the potential for confusion as to whether an institution was federally insured. The officials also maintained that if NCUA were responsible for enforcing and implementing the section, the costs would be passed on to federally insured credit unions.[40] In addition, the officials stated that NCUA regulation of a private insurer would result in a regulatory conflict of interest that might erode confidence in NCUA's authority.[41] They said that if the private deposit insurance system were to fail while under NCUA's purview, confidence in NCUA, as well as federal deposit insurance for credit unions, could weaken to a point that it could have a devastating impact on the financial health of the credit union system.

In our discussions with FDIC officials, they expressed several reasons—similar to those presented by NCUA—why FDIC should not be charged with enforcing section 43. First, FDIC officials noted that FDIC insures the deposits at banks and savings associations—but does not regulate or supervise credit unions or insure deposits at these institutions. Officials also expressed concern that placing the responsibility with FDIC would closely identify a federal agency with uninsured credit unions and, in turn, create the potential for confusion as to whether an institution was federally insured.

[40] NCUA operations are entirely supported by fees paid by federal credit unions and income from the insurance deposit (1 percent of insured shares) maintained with NCUSIF by all federally insured credit unions. NCUA may also assess insurance premiums on its insured credit unions but has not done so in over 10 years.

[41] In its role as a primary share insurer, NCUA is a competitor of any private company that provides primary share insurance. Accordingly, NCUA's motivations for taking any action perceived as adverse to a private share insurer would be subject to question.

Industry Views on Private Deposit Insurance and the Enforcement of Section 43 Requirements

While officials from the National Association of Federal Credit Unions (NAFCU) oppose the option of private primary deposit insurance for credit unions, NAFCU officials believe that since private primary deposit insurance is an option, then section 43 requirements are important and FTC should enforce these requirements for several reasons. NAFCU officials believe that members of privately insured credit unions should be adequately informed that deposits in these institutions are not federally insured. NAFCU officials stated that the enforcement of the provisions in section 43 requires an expertise in "consumer protections" and "deceptive practices." NAFCU takes the position that FTC has this expertise and, further, that the entity does not need expertise in "safety and soundness of depository institutions." NAFCU officials also believe that federal financial regulators, such as NCUA and FDIC, are not the appropriate oversight entities for issues related to private deposit insurance because their involvement would imply federal backing. Further, the involvement of NCUA or FDIC in the enforcement of the requirements in section 43 could create conflict between the federal and private insurer. NAFCU officials commented, however, that it would be beneficial for FTC to consult with FDIC and NCUA regarding the enforcement of these requirements because of their expertise. Regarding enforcement, NAFCU officials believe that state regulators could be involved in, but not solely responsible for, enforcing certain section 43 requirements. For example, during state exams of credit unions, examiners could determine if the credit union were compliant with disclosure and insurability requirements of section 43 and then submit a certification to FTC.

Credit Union National Association (CUNA) and National Association of State Credit Union Supervisors (NASCUS) support the option of private deposit insurance for credit unions and believe that the requirements in section 43 are important and that FTC should enforce the requirements in section 43. CUNA's public position is that it supports the option of private deposit insurance because the association believes "it is an integral part of the dual-chartering system for credit unions (the system allowing credit unions meaningful choice between a state and federal charter)." NASCUS also supports the option of private deposit insurance for credit unions because the association thinks credit unions should have a choice when it comes to deposit insurance. Specifically, NASCUS believes that if there was only a single insurer (such as NCUA) this would create a uniform approach, thus obviating state choice, and could revert to a rigid framework.[42]

Tying NCUA and FDIC Insurance to the Regulation of Uninsured Entities Presents a Conflict of Interest

As the agencies charged with administering and safeguarding their respective insurance funds, NCUA and FDIC have an interest in seeing that the public does not lose confidence in the federal deposit insurance system. The section 43 disclosure requirements help protect this interest by imposing measures designed to inform depositors at nonfederally insured institutions that their deposits are not backed by the federal government. To the extent that institutions comply with section 43, there is a reduced risk that depositors in nonfederally insured institutions would mistakenly believe that their deposits are federally insured. Because section 43 protects NCUA and FDIC interests, it can be argued that those agencies should be responsible for enforcing the provision. Although that proposition has some merit, we have no reason to disagree with statements by NCUA and FDIC officials that placing both private insurers and institutions lacking federal deposit insurance under the jurisdiction of NCUA and FDIC could increase the risk of depositor confusion and create the potential for a loss of public confidence in the federal deposit insurance system. Moreover, assigning responsibility to NCUA and FDIC would mean that federally insured depositary institutions would subsidize the regulation of nonfederally insured institutions.[43] However, we recognize that deciding who pays the cost for regulating nonfederally insured institutions is a complicated issue.

Some observers have asserted that if NCUA were responsible for regulating the disclosures required by section 43, a depositor's knowledge that the disclosure was prescribed by NCUA could generate confusion as to NCUA's relationship with a nonfederally insured institution. The identity of the federal agency may be of no consequence because the consumer might not understand, or even be aware of, which federal agency prescribed the disclosure requirements. However, should NCUA determine, as FTC has, that section 43 calls for substantial disclosure of the risks relating to a specific depository institution and its insurer, NCUA

[42] We found no evidence to suggest that this is a valid concern. We are unaware of any private insurer providing deposit insurance for banks or thrifts, and the bank insurance system operates successfully with FDIC as the only account insurer.

[43] Because FDIC's concerns mirror those expressed by NCUA, our discussion refers only to NCUA's position.

would risk significant exposure to conflict of interest charges. For example, if NCUA were to impose requirements on privately insured credit unions that were considered by states or institutions to be too stringent, its partiality as a regulator would be questioned. The costs of compliance with such requirements could cause privately insured institutions to turn to federal deposit insurance, thus adversely affecting the private deposit insurer, NCUA's competitor.

We recognize that in two instances Congress has chosen NCUA to implement laws that apply to credit unions regardless of whether they are federally insured. The Truth in Savings Act (TISA) requires that NCUA implement its provisions with respect to all credit unions, regardless of who insures them. The Home Mortgage Disclosure Act (HMDA) also charges NCUA with implementing responsibility for all credit unions regardless of their insured status. See appendix II for an illustration of who is responsible for the enforcement of various laws at credit unions. NCUA has promulgated regulations implementing TISA and issued guidelines for credit union reporting under HMDA.[44] By implementing these laws, NCUA has demonstrated the capacity to regulate operations of credit unions it does not insure. Moreover, the cost of enforcing these laws with respect to nonfederally insured credit unions is passed on to insured credit unions. It is particularly noteworthy that NCUA's TISA regulations require specific disclosures about the terms and conditions of deposit accounts at both federally and nonfederally insured institutions. However, NCUA's administration of those laws does not present the same potential or perceived conflict of interest. The requirements under those laws apply equally to federally insured and nonfederally insured institutions. In contrast, regulations under section 43 would, by definition, treat the institutions differently and expose NCUA to a regulatory conflict of interest.

The regulatory conflict of interest also would exist with respect to NCUA enforcement of the audit provision. NCUA would be regulating its competition. If NCUA, like FTC, were to consider enforcement of the requirement as called for by evaluating the conclusions of the audit or scrutinizing the financial health of the insurer, NCUA's action would be inherently suspect. In addition to the regulatory conflict of interest, closely associating NCUA with nonfederally insured institutions could have an

[44] NCUA's TISA regulations are contained in 12 C.F.R. Part 707 (2003). NCUA guidance on HMDA compliance is contained in NCUA publications.

undesirable “shadow effect.” For example, if NCUA were to be responsible for reviewing the private insurer’s audit report, NCUA would be closely associated with determinations about the financial health of the private deposit insurer. Should the insurer, which is subject to state regulation, fail to honor its insurance commitments, NCUA’s credibility as a regulator would be compromised.

Concerns about a regulatory conflict of interest also would accompany NCUA actions involving the shut-down requirement. The agency would be closely associated with liquidating institutions it does not insure and safeguarding deposits it does not protect. In effect, NCUA would be shutting down the institutions that are members of the agency’s competition—the private deposit insurer. Similarly, NCUA enforcement of the look alike provision could be seen as an attempt by the agency to eliminate entities that compete with federally insured credit unions.

NCUA’s concern that its enforcement of section 43 would require federally insured institutions to subsidize the regulation of institutions that forgo insurance, in part involves a question of a level playing field; that is, federally insured institutions would be forced to pay the cost of regulating competitors who may benefit from avoiding federal deposit insurance. This concern also touches on other considerations. For example, this additional cost could act as an incentive for federally insured credit unions to convert to private deposit insurance. However, who pays for the oversight of nonfederally insured institutions is a more complicated issue, because federally insured institutions could also benefit from clarifying for consumers the insurance status of these institutions, and if FTC oversees nonfederally insured institutions, taxpayers bear the costs.

FTC Opposes Having to Implement and Enforce Section 43

Section 43 specifies that FTC shall enforce compliance with its requirements, and any regulations or orders issued under it.[45] In addition, the section charges FTC with specific responsibilities. FTC is to prescribe “the manner and content of disclosure required under the section” in order to “ensure that current and prospective customers understand the risks involved in forgoing federal deposit insurance.”[46] Also, the section authorizes FTC, in consultation with FDIC, to exempt an institution from

[45] 12 U.S.C. § 1831t(g).

[46] 12 U.S.C. § 1831t(c).

the shut-down provision.[47] In addition, section 43 authorizes FTC to determine that an institution not chartered as a depository institution nonetheless can be subject to the section.[48] FTC staff told us that because of questions about the Commission's authority under section 43 and the Commission's lack of expertise to carry out the section in accordance with the staff's perception of what the section requires, FTC is not the appropriate federal agency to enforce the section.

FTC Staff Said That Questions about the Commission's Authority under Section 43 Could Interfere with Its Ability to Enforce the Section

According to FTC staff, the language of section 43 charging the Commission with responsibility for enforcing the section (charging provision) contains an ambiguity that could lead to challenges against the Commission's authority under the section. As noted above, the charging provision specifies that the FTC shall enforce section 43 "under the [FTC] Act." The FTC Act, however, limits the Commission's jurisdiction in ways that are inconsistent with FTC's responsibilities under section 43. For example, FTC and federal courts have interpreted the FTC Act to mean that the Commission has no jurisdiction over nonprofit entities, a group that includes credit unions.[49] Another provision of the FTC Act (Section 6), which authorizes FTC to conduct investigations, require reports and promulgate rules and regulations to carry out the FTC Act, expressly excludes the business of insurance from those authorities except under very limited circumstances.[50] According to FTC staff, this limitation raises

[47] 12 U.S.C. § 1831t(e)(1). The shut-down provision prohibits a depository institution (other than a bank) that lacks federal deposit insurance from using the mails or any instrumentality of interstate commerce to receive or facilitate receiving deposits except (1) as permitted by FTC after consultation with FDIC or (2) where the appropriate supervisor for the state in which the institution is chartered determines that the institution meets all eligibility requirements for federal deposit insurance.

[48] The definition of "depository institution" contained in the section includes any entity FTC determines to be engaged in the business of receiving deposits, which "could reasonably be mistaken for a depository institution by the entity's current or prospective customers." 12 U.S.C. § 1831t(f)(2)(B).

[49] The FTC Act specifically excludes federally chartered credit unions from its provisions. 15 U.S.C. § 45 (2000); *See also* 15 U.S.C. § 57a(f)(3), (f)(4). There is no specific exclusion for state-chartered credit unions. However, the FTC Act has been interpreted to preclude FTC from enforcing the act against certain nonprofit entities. *See Community Blood Bank v. FTC*, 405 F.2d 1011, 1022 (8th Cir.1969). The FTC Act gives the Commission authority over "persons, partnerships, or corporations." However, the act's definition of "corporation" refers only to for-profit entities. 15 U.S.C. § 44.

[50] 15 U.S.C. § 46. This provision authorizes FTC to conduct antitrust investigations even if the investigations are applicable to the business of insurance. Also, FTC may conduct studies and prepare reports relating to the business of insurance only upon receiving a request approved by Congressional committees as specified in the section.

questions about the Commission's authority to enforce the audit provision in section 43, which applies specifically to private insurers.

FTC staff said that FTC's jurisdiction with respect to the audit provision, as well as disclosures about deposit insurance, also would be subject to challenge because of limitations the McCarran-Ferguson Act imposes on federal laws that relate to the business of insurance. Under the McCarran-Ferguson Act, a federal law applicable to the business of insurance can be preempted by a state insurance law. Specifically, the McCarran-Ferguson Act precludes application of a federal statute in the face of a state law "enacted . . . for the purpose of regulating the business of insurance," if the federal measure does not "specifically relate to the business of insurance," and would "invalidate, impair, or supersede" the state's law.[51] The act also specifies that the FTC Act is applicable to the business of insurance "to the extent that such business is not regulated by State law."[52] According to FTC staff, this latter provision displaces application of the FTC Act where there is state regulation of the business of insurance. The staff explained that FTC's authority under section 43 is unclear because the section requires FTC to enforce the deposit insurance disclosure requirements and the audit provision "under the [FTC] Act" even though the FTC Act does not apply to insurance. FTC staff believe that enforcement of the disclosure provisions could be subject to challenge in states that regulate deposit insurance, and that enforcement of the audit provision would be subject to challenge because the State of Ohio specifically regulates the only private deposit insurer, ASI.

FTC Staff Raised Practical Concerns about the Commission's Ability to Carry Out Section 43

FTC staff raised several concerns about the Commission's ability to carry out section 43 responsibilities. One concern relates to the manner in which FTC would exercise its rulemaking authority under the section. Section 43 does not specify the authority under which FTC's implementing rules should be promulgated. To the extent that the Commission's rulemaking authority under the section is subject to requirements of the FTC Act, FTC staff made two points. They noted that the Commission's general rulemaking authority under the FTC Act may be exercised only "for purposes of carrying out the provisions of [the FTC Act]."[53] The

[51] 15 U.S.C. § 1012(b) (2000). See *Humana Inc. v. Mary Forsyth*, 525 U.S. 299 (1999) (citing *Department of Treasury v. Fabe*, 508 U.S. 491 (1993)).

[52] 15 U.S.C. § 1012(b).

[53] 15 U.S.C. §§ 46(g), 58.

Commission also has special rulemaking authority under section 18 of the FTC Act with respect to unfair or deceptive acts or practices.[54] That section contains specific procedures FTC must follow in prescribing rules that define unfair or deceptive acts or practices. Among other things, section 18 requires that Commission rules define such acts or practices with specificity and establishes rigorous procedures for issuing the rules. FTC staff asserted that without specific guidance from Congress as to the Commission's rulemaking authority, the Commission could face having to promulgate rules under section 43 in accordance with the requirements in section 18 of the FTC Act.[55] They stated that because the separate rulemaking authorities involve different procedures and authorize different remedies, the absence of guidance in this area makes it difficult for FTC to carry out its rulemaking responsibilities under section 43.

FTC staff also raised concerns that section 43 requires the Commission to engage in activities that are incompatible with the manner in which FTC undertakes its consumer protection mission or are beyond FTC's expertise. According to the staff, section 43 calls upon FTC to engage in activities more suitable for a supervisor of depository institutions. These include reviews of insurance company accounting practices and audits, supervisory examinations or inspections, specification of disclosures that should include the risk profiles of depository institutions and their private deposit insurers, and the regulation and possible closure and liquidation of depository institutions and other entities that could be mistaken for depository institutions (such as securities firms that offer accounts with deposit account characteristics). The staff asserted that these responsibilities call for close supervision by an agency that, unlike FTC, has the expertise, tools, and resources to assess and regulate the operations of depository institutions and is knowledgeable about risks associated with depository institutions and deposit insurance.

[54] 15 U.S.C. § 57a.

[55] 15 U.S.C. § 57a.

Several provisions of section 43 underlie FTC's concern that the section calls for expertise the Commission does not have.[56] The first is the requirement that FTC promulgate disclosure regulations to ensure that current and prospective customers understand the risks involved in forgoing federal deposit insurance. Commission staff asserted that disclosure of those risks requires more than a standardized notice that the institution is not federally insured and that the federal government does not guarantee that the depositor will get back their deposits. The staff maintained that disclosure could involve a discussion of a depository institution's financial strength and liquidity, as well as the health of the private insurer, because the risk of not having federal deposit insurance would be tied to the health of both the institution and the insurer.

The staff also stated that even if disclosure did not require discussion of the safety of the particular institution and insurer, any explanation about the risks of forgoing federal deposit insurance would be beyond FTC's expertise because the Commission lacks the expertise necessary to define those risks. For example, they said that the disclosure requirement creates the dilemma that too much emphasis on the risks of forgoing federal deposit insurance could dissuade depositors from using uninsured institutions, thus weakening them; whereas, too little risk disclosure could mean that such depositors would be inadequately informed. In addition, the staff asserted that the Commission lacks the ability to determine which documents and records should contain the risk disclosure.

The second provision of concern to FTC is the shut-down provision. According to FTC staff, this section would require expertise in depository institution operations and depositor protection. They maintained that enforcement of this provision could require FTC to do more than merely declare that an institution must stop doing business. They asserted that if

[56] FTC's concerns addressed in this report relate to section 43 of the FDI Act, which we understand to be the subject of the mandate requiring this report. Section 43 was enacted as section 151(a) of FDICIA. In addition to its concerns about section 43, FTC referred to 151(b) of FDICIA, which requires that, not later than 240 days after the date of enactment of FDICIA, any private deposit insurer shall provide a business plan to each appropriate supervisor of each state in which deposits are received by any depository institution lacking federal deposit insurance, the deposits of which are insured by a private deposit insurer. The plan must contain details relating to the insurer's financial health, management, and other matters. FTC maintains that it has no expertise in these areas and that, if FTC were obligated to enforce section 151 as enacted, the Commission would have to determine whether ASI complied with this requirement by, among other things, scrutinizing the contents of the plan.

an entity were instructed to shut down, the Commission would have to be prepared to enforce that shut-down, which would necessitate “winding up” the operations of the entity, a role that would require expertise in the operation of depository institutions and the protection of customer deposits. The staff also expressed a concern that section 43 fails to provide standards for FTC to consider in deciding whether an institution is eligible for an exemption from the shut-down provision. They maintained that in deciding upon an exemption the Commission likely would have to engage itself in the complexities of depository institution law.

Another aspect of section 43 that FTC believes to be beyond its expertise is the look-alike definition. The definition of “depository institution” in section 43 includes any entity FTC determines to be engaged in the business of receiving deposits, and could reasonably could be mistaken for a depository institution by the entity’s current or prospective customers.[57] Under this authority, FTC could determine that an entity not chartered as a depository institution is subject to section 43. FTC staff asserted that the Commission lacks the expertise necessary to determine whether an entity’s business constitutes “receiving deposits” or what would cause customers to mistake an entity for a depository institution. Any entity determined to be a look alike and not exempted would be subject to section 43, including the requirements for disclosures regarding lack of federal deposit insurance (even if it holds other forms of federal deposit insurance). According to FTC staff, proper implementation of this provision, in conjunction with the shut-down provision, could lead to shutting down a variety of institutions such as securities firms and mutual funds.

FTC officials also stated that the Commission lacks the expertise necessary to enforce the audit requirement for private insurers. As mentioned previously, section 43 requires any private deposit insurer to obtain an annual audit from an independent auditor using generally accepted auditing standards.[58] The audit must determine whether the insurer follows generally accepted accounting principles and has set aside sufficient reserves for losses. FTC staff stated that diligent enforcement would require a review of the auditor’s determinations, which, in turn, would necessitate expertise and adequate resources for assessing both the quality of the audit and the financial health of the insurer. FTC staff

[57] 12 U.S.C. § 1831t(f)(2)(B).

[58] 12 U.S.C. § 1831t(a)(1).

asserted that the Commission does not possess this expertise. The staff also were of the view that financial audits do not and cannot include determinations about whether reserves set aside for losses are sufficient. The staff said that FTC does not have expertise regarding loss and reserve issues with which to determine whether some form of substitute assurances should be deemed sufficient.

FTC Best among Candidates for Enforcement Role

Although we found no agency was ideally suited to carry out the responsibilities set forth in the provision, based on our review of the concerns raised by FTC, NCUA and FDIC, we found no compelling reason to remove FTC from its responsibility as the primary agency responsible for implementing section 43. FTC's concerns about its authority and resources are rooted in an interpretation of the section that calls for an extensive federal presence in the regulation of private deposit insurance and depository institutions. The scheme of section 43, particularly in the context of federal deposit insurance, suggests that a more modest interpretation is appropriate, although modifications to the section would enhance the Commission's ability to enforce the section.

FTC's Concerns about Potential Challenges to Its Authority under Section 43 Can Be Addressed

Although FTC's concerns about potential challenges to its authority under section 43 are not unrealistic, it appears that the Commission has authority to implement and enforce the requirements of the provision even if the Commission would not otherwise have jurisdiction under the FTC Act or McCarran-Ferguson Act. A challenge to FTC's authority would arise from uncertainties about what Congress intended by instructing FTC to enforce the section "under the FTC Act." The phrase indicates that the Commission must enforce the section under the FTC Act even though, under the FTC Act, the Commission would not have authority to enforce certain provisions of the section or take certain other regulatory actions. Interpreting section 43 to mean that FTC enforcement actions are subject to all provisions of the FTC Act would lead to unreasonable results. Among other things, FTC would be without authority to perform the actions specifically prescribed in section 43. Moreover, it is clear that Congress intended that the section would apply to credit unions because section 43 specifically addresses state-chartered credit unions in the shut-down provision.[59] Even if FTC's authority under the FTC Act did not extend to nonprofit entities before Congress enacted section 43, such a limitation did not preclude Congress from subjecting credit unions to FTC's authority under that provision.[60] We interpret section 43 as authorizing FTC to enforce the section by using the enforcement powers provided in the FTC Act and not as a limitation on FTC's authority that would defeat several purposes of the section.[61]

It also appears that the McCarran-Ferguson Act does not undermine FTC's authority to implement section 43. The pertinent part of that act states as follows:

> "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance."[62]

As interpreted by the Supreme Court, this provision precludes application of a federal statute in the face of a state law "enacted . . . for the purpose of regulating the business of insurance," if the federal measure does not "specifically relate to the business of insurance," and would "invalidate,

[59] 12 U.S.C. § 1831t(e)(1)(A) (prohibiting depository institutions from engaging in interstate commerce unless, in the case of credit unions, the appropriate state supervisor has certified that the institution is eligible for federal deposit insurance for credit unions). Because all federally chartered depository institutions must have federal deposit insurance, section 43 can only apply to state-chartered institutions.

[60] Although the repeal or amendment of a statute by implication is disfavored, where two statutory provisions are irreconcilable and the latter statute contains an affirmative showing of Congress' intention to repeal or amend the earlier statute, the latter statute repeals the irreconcilable provision of the former statute. *See St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 788 (1981) (citations omitted).

[61] See *Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982)* ("Interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available."). Under the FTC Act, FTC may conduct administrative proceedings to enter a cease and desist order to stop unfair methods of competition and unfair or deceptive acts or practices. 15 U.S.C. § 45. Also, the Commission may institute civil proceedings for violations of rules regarding unfair or deceptive acts or practices and for violations of cease and desist orders regarding an unfair or deceptive act or practice. 15 U.S.C. § 57b.

[62] 15 U.S.C. § 1012(b).

impair, or supersede" the state's law.[63] One purpose of this provision is to protect state insurance laws against inadvertent preemption by federal law.[64] Section 43 does not inadvertently apply to insurance. Rather, to the extent that the section specifically relates to deposit insurance and to private providers of that insurance a state law relating to the same subject matter would be preempted.[65]

Because the audit provision is valid under the McCarran-Ferguson Act, FTC staff concerns about challenges to the Commission's authority to enforce the provision appear to be misplaced. Should FTC take an action arguably inconsistent with the role contemplated in section 43, such as regulating the safety and soundness of providers of private deposit insurance, the McCarran-Ferguson Act might serve as grounds to

[63] See *Department of Treasury v. Fabe, 508 U.S. 491, 501 (1993).* It could be argued that neither section 43 nor a state law covering the same subject matter would be within the McCarran-Ferguson Act because neither law relates to "the business of insurance" as the term has been defined by the courts in determining the scope of state laws under the McCarran-Ferguson Act. See, e.*g Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982) (in determining whether a practice constitutes the business of insurance, courts consider whether the practice has the effect of transferring or spreading a policyholder's risk; whether the practice is an integral part of the policy relationship between the insurer and the insured; and whether the practice is limited to entities within the insurance industry).

[64] *Patton v. Triad Guaranty Insurance*, 277 F.3d 1294 (11th Cir.) (2002).

[65] If section 43 were interpreted as not applying specifically to the business of insurance, the McCarran-Ferguson Act still would not bar FTC from enforcing the audit requirement. As the language of the McCarran-Ferguson Act clearly states, a federal law does not violate the act unless the law invalidates, impairs, or supersedes a state insurance law. The Supreme Court has held that when a federal law is applied in aid or enhancement of state regulation, and does not frustrate any declared state policy or disturb the state's administrative regime, the McCarran-Ferguson Act does not bar the federal action. *Humana Inc. v. Forsyth*, 525 U.S. 299 (1999). At present, the only fully functioning provider of private deposit insurance, ASI, is subject to regulation by the State of Ohio. As discussed earlier, the audit requirements under Ohio law achieve a purpose similar to that of the audit requirement in section 43.

challenge the action. However, the McCarran-Ferguson act does not stand as a general bar to FTC's authority to enforce the audit requirement.[66]

Lack of Guidance in Section 43 for Rulemaking Procedures Can Be Addressed

The only explicit rulemaking requirement in section 43 is that FTC issue regulations or orders prescribing the manner and content of disclosure required under the section.[67] Section 43 does not designate the procedures FTC should follow in promulgating those rules or orders. Also, to the extent that FTC has authority to issue other regulations under the section, the source of that authority is less clear. Uncertainty about FTC's rulemaking authority might complicate the Commission's ability to promulgate regulations, but these potential complications do not appear to undermine FTC's authority to carry out the section.

Under the FTC Act, the Commission has two types of rulemaking authority. The Commission has general authority to make rules and regulations for the purpose of carrying out the act.[68] In addition, FTC has special rulemaking authority the Commission must use for issuing rules with respect to unfair or deceptive acts or practices. The special rulemaking authority requires, among other things, that the Commission define unfair or deceptive acts or practices with specificity and follow stringent rulemaking procedures.[69] If the Commission's authority to issue regulations under section 43 is subject to the requirements of the FTC Act, then the Commission would have to rely upon its special rulemaking

[66] FTC staff suggested that because FTC's enforcement authorities are contained in the FTC Act, the Commission's use of those authorities to enforce the audit requirement might amount to the application of the FTC Act to private deposit insurance, i.e., ASI. Contrary to FTC's concern, the McCarran-Ferguson Act does not affect FTC's authority under section 43. The McCarran-Ferguson Act does not prohibit FTC from enforcing OGC laws other than the FTC Act if they otherwise satisfy McCarran-Ferguson requirements. As previously noted, it is unclear whether activities subject to section 43 constitute "the business of insurance" as that term has been defined by the courts." Moreover, FTC's concern is directly contrary to the scheme established in section 43. We note that when Congress enacted section 43 it was fully aware that states regulated private deposit insurance. See, e.g., 12 U.S.C. § 1831t(a)(2), (e).

[67] 12 U.S.C. § 1831t(c). FTC staff indicated that the Commission's enforcement responsibilities would warrant additional regulations concerning other provisions in the section.

[68] 15 U.S.C. § 46(g).

[69] 15 U.S.C. § 57a.

authority.[70] It is unclear whether the Commission's authority to issue rules under section 43 is subject to the FTC Act, however. If FTC Act requirements do not apply, then FTC could rely upon the less stringent rulemaking requirements for informal rulemaking under the Administrative Procedure Act.[71] Because section 43 does not provide specific guidance for which of FTC's rulemaking authorities applies, it could affect the manner in which the Commission undertakes its rulemaking. However, the lack of guidance does not preclude the Commission from carrying out its responsibilities under the section.

FTC's Concern That Section 43 Enforcement Would Require More Expertise Is Generally Not Warranted

In addition to perceived jurisdictional limitations, FTC staff maintained that enforcement of the section requires expertise and resources the Commission does not have and would require FTC to take actions inconsistent with its consumer protection mission. FTC staff asserted that enforcement of the disclosure requirement and the promulgation of regulations apprising consumers of the risk of not having federal deposit insurance, as well as proper enforcement of the audit requirement and shut-down provision, require an in-depth knowledge of depository institutions and deposit insurance and FTC oversight of the safety and soundness of institutions subject to section 43. Enforcement of the disclosure provisions does not necessarily require such in-depth expertise, although FTC could benefit from consulting with other federal regulators or others to gain this expertise to more effectively enforce these provisions.

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[70] Although FTC officials described use of the special rulemaking authority as "cumbersome," we note that the Commission relies on that authority to issue regulations against false advertising. See 15 U.S.C. § 52. This section specifies that false advertising is an unfair or deceptive act or practice; rules covering such activity must be promulgated under the special rulemaking authority.

[71] See *Citizens to Save Spencer County v. Environmental Protection* Agency, 600 F.2d 844 (D.C. Cir. 1979) (agency rulemaking authority may be implied from general purposes and other substantive provisions of an act (citation omitted)). In this regard, we note the possibility that the disclosure rules required by section 43 would be exempt from the Administrative Procedure Act. A regulation that "merely tracks" statutory requirements and thus simply explains something the statute already requires has usually been deemed interpretative and, therefore, exempt from the Administrative Procedure Act. See *National Family Planning and Reproductive Health Ass., Inc. v. Sullivan*, 979 F.2d 227 (D.C. Cir., 1992) (citations omitted). With respect to disclosure rules under section 43, the section requires FTC to issue regulations or orders prescribing the manner and content *"of disclosure required under this section"* [emphasis supplied]. Section 43 specifically states the disclosure required under the section and does not specifically require the disclosure of additional information. 12 U.S.C. § 1831t(b) (disclosure must state that the institution is not federally insured and that if the institution fails, the federal government does not guarantee that depositors will get back their money).

The only specific rulemaking mandate in section 43 requires FTC to prescribe "the manner and content of disclosure required under this section" in order "to ensure that current and prospective customers understand the risks involved in forgoing federal deposit insurance." As noted previously, section 43 specifically requires disclosure of two facts: (1) that the depository institution is not federally insured and (2) if the institution fails the federal government does not guarantee that depositors will get back their money. FTC staff interprets the rulemaking mandate to mean that the Commission must issue regulations or orders requiring disclosure of information that goes beyond what is specifically required under section 43. It appears that a less extreme interpretation of the disclosure requirement—one that does not compromise FTC's ability to carry out the requirement—would be consistent with section 43.

Even if the requirement for disclosure regulations calls for more than the disclosure specifically described in section 43, it is not clear that Congress intended the regulations to require a discussion of the safety and soundness of the depository institution and its private insurer. It appears that Congress enacted the disclosure requirements in section 43 to ensure that consumers are informed about an institution's lack of federal deposit insurance.[72] There is no indication in the section or its legislative history that Congress also intended disclosure about the risks associated with the private deposit insurer. The purpose of deposit insurance is to free depositors from having to assess an institution's safety with respect to their deposits, up to the coverage limit; deposits are protected up to that limit even if the institution becomes unsafe or unsound. With respect to the safety of deposits, risk disclosure is unnecessary. FTC staff maintains that disclosure regarding private deposit insurance should be treated differently because, unlike federal deposit insurance, private deposit insurance is subject to the risk that a private insurer may not be able to protect the deposits it insures. We do not take issue with FTC's observation about the potential risks of private deposit insurance. However, nothing in section 43 indicates that Congress intended that disclosures with respect to private deposit insurance should be treated any differently; nothing in the section indicates that FTC should preempt the states in assessing the safety and soundness of privately insured institutions and their insurers. In section 43 Congress deferred to the

[72] See S. Rep. No. 102-167 at 61 (Oct. 1, 1991) (explaining that the purpose of the disclosure requirement is to ensure that depositors in nonfederally insured institutions are aware that their deposits are not federally insured).

states on whether to permit the operation of privately insured depository institutions. It is reasonable to conclude that Congress anticipated that depositors at those institutions should rely upon the states to oversee the safety and soundness of private deposit insurers.

Finally, we note that the section 43 requirement for disclosure regulations is similar to other laws that require FTC to regulate disclosure without regard to its expertise concerning the subject of the disclosure. For example, under the Fair Packaging and Labeling Act, FTC regulates disclosure about a broad array of commercial items defined generically as "consumer commodities."[73] Under the FTC Act, the Commission has responsibility for preventing false advertising without regard to the nature of the product.[74] Also, FTC enforces several federal consumer protection laws applicable to financial institution disclosures, including the Truth in Lending Act, the Consumer Leasing Act, the Equal Credit Opportunity Act, and the Electronic Funds Transfer Act.[75] Moreover, the Commission already has demonstrated that it has the ability to regulate extensively how financial institutions must make disclosures about financial transactions and customer financial privacy.[76]

Certain FTC Concerns Do Raise Questions about Its Enforcement Capabilities or Applicability of Its Authority

With respect to the shut-down provision, whether FTC enforcement requires expertise in depository institutions and deposit insurance depends upon how far the Commission might seek to extend its enforcement authority. Under the most likely enforcement scenario, depository institution expertise would not be necessary. The shut-down provision prohibits any depository institution lacking federal deposit insurance from engaging in interstate commerce unless the appropriate state supervisor has determined the institution's eligibility for federal

[73] The Fair Packaging and Labeling Act, Pub. L. No. 89-755 (1966), as amended, is codified at 15 U.S.C. §§ 1451, et. seq. (2000 & 2002 Supp.).

[74] 15 U.S.C. § 52. We note that under both the Fair Packaging and Labeling Act and the FTC Act, FTC's jurisdiction is not unlimited; many commodities, other articles or services such as food and drug items or securities and commodities transactions may not be within FTC's authority under those acts.

[75] See FTC letter to the Board of Governors of the Federal Reserve System dated February 7, 2002, summarizing its 2001 enforcement activities and methods. FTC also has jurisdiction to enforce other laws that affect depository institutions, such as the Fair Credit Reporting Act and the Fair Debt Collections Practice Act.

[76] See 16 C.F.R. Part 313 (2003). FTC has an extensive program guiding financial institutions on their financial privacy disclosure obligations. See http://www.ftc.gov/privacy/glbact/glb-faq.htm#A.

deposit insurance. Assuming that FTC were not to grant an exemption, enforcing the provision could involve an FTC enforcement action under the FTC Act to shut down the institution. However, because depository institutions subject to section 43 are state-chartered, states likely would have primary responsibility for "winding up" an institution once it has ceased doing business.[77] Section 43 would not prevent the application of federal bankruptcy laws or laws administered by federal agencies. FTC staff pointed out that under some circumstances it might be appropriate for the Commission to remain involved in winding up an entity subject to shut down to ensure that deposits were protected. To the extent that the Commission might remain involved, partnering with the state would be appropriate.

FTC staff also stated that FTC lacks the expertise necessary to evaluate a state's determination of an institution's eligibility for federal deposit insurance. Nothing in section 43 suggests that FTC is to oversee the states in this regard. Congress deferred to the states with respect to the determination. We agree with the FTC staff that the extent to which FTC can challenge a state's determination is unclear, but we see nothing in the statute contemplating FTC review of state determinations.

Another of FTC's concerns about the shut-down provision—that section 43 does not provide standards for the Commission to apply in deciding whether to exempt an entity from the provision—appears to have been partially addressed by Congress when it enacted the section. Section 43 authorizes FTC to permit an exemption from the shut-down requirement "in consultation with the Federal Deposit Insurance Corporation."[78] Thus, Congress specifically did not rely on FTC's independent judgment should FTC consider an institution for the exemption. The section, however, does not provide guidance on the factors the Commission should consider in deciding whether an institution is eligible for an exemption. The extent to which this lack of guidance might affect FTC's enforcement of the provision is unclear. We note, however, that FTC could seek to resolve uncertainties about exempting an institution by consulting with FDIC, as contemplated by section 43.

[77] Section 43 would not prevent the application federal bankruptcy laws or laws administered by federal agencies.

[78] 12 U.S.C. § 1831t(e)(1).

The merit of FTC's concern regarding the look alike provision depends upon the Commission's perception of the role Congress intended it to have. Under the look alike provision, the Commission has discretion to decide whether an entity not chartered as a depository institution nonetheless should be subject to section 43. FTC staff asserted that the Commission could exercise this authority in a way that would include various uninsured institutions where funds are deposited, including securities firms and mutual funds. Such institutions would be subject to FTC enforcement of the disclosure requirements and the shut-down provision. According to FTC staff, proper enforcement of section 43 requires the Commission to promulgate a regulation defining look alike institutions and subjecting them to section 43. The staff asserted that because of FTC's lack of expertise regarding deposits, the Commission would have to define the look alike entities broadly, thus subjecting a potentially vast group of entities to the section. FTC's concern in this regard overlooks the fundamental principal that a statute should not be interpreted to produce absurd results.[79] It does not appear that Congress intended that FTC would invoke the look alike provision broadly to include any entity that accepts deposits. For example, a reasonable interpretation of the look alike requirement does not anticipate shutting down entire industries and entities already subject to extensive disclosure regulation under federal law, such as securities firms and mutual funds.[80]

FTC staff also expressed concerns about what role the Commission would have to take if the Commission were to shut down a business, particularly if FTC took the action under the look alike authority. The staff stated that

[79] See *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. at 575, ("Interpretations of a statute which would produce absurd results are to be avoided if alternative [p. 34-footnote 66] interpretations consistent with the legislative purpose are available.").

[80] Under federal case law, certificates of deposit and other deposit instruments or accounts are not considered investment contracts subject to the federal securities laws if the instruments or accounts are subject to a regulatory regime that eliminates the risk of loss, such as deposit insurance. See, e.g., *Bair v. Krug*, 1987 U.S. Dist. LEXIS 15904 (D. Nev. Apr. 27, 1987) (certificates of deposits found not to be securities where they were issued by an institution in a state that had a comprehensive regulatory system providin depositors with protection that "virtually guarantees" repayment to purchasers of such certificates); see also, *Wolf v. Banco Nacional de Mexico (Banamex)*, 739 F.2d 1458 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985) (certificates of deposit not securities because foreign bank that issued them was subject to extensive home country regulation, even though deposits were not insured by the home state)." Look-alike institutions could be subject to Securities and Exchange Commission (SEC) jurisdiction where the deposits they offer constitute investment contracts or another type of security. The lack of compliance with section 43 would not alone constitute a securities law violation, however.

the Commission would lack expertise necessary to wind down the institution and protect its customers' funds. We note that entities subject to the shut-down provision would be subject to state and federal laws governing the winding up of a business enterprise. In section 43, Congress did not indicate what, if any, role FTC should play in a shut-down scenario. However, nothing in section 43 indicates that Congress intended to preempt laws governing the winding up of an entity.

FTC's concerns about monitoring compliance with the audit provision are more substantial. The audit provision does not require FTC to test the conclusions of the audit. It appears that the Commission could carry out its responsibility simply by relying upon the auditor's attestations and checking with the appropriate parties to ensure that the audit report was properly distributed. However, as FTC staff pointed out, proper enforcement of the provision could, under certain circumstances, call for close scrutiny of the audit. According to FTC staff, because the Commission lacks expertise in this area, it might be unaware of circumstances warranting close scrutiny of the audit report.

Clarifying FTC's Authority and Providing Some Flexibility Could Ensure Effective Enforcement of Section 43

While we found that FTC was the best candidate to enforce section 43 provisions, clarifying FTC's authority and providing additional flexibility in administering the section could help address some of the Commission's concerns about its authority and ability to enforce the provision without undermining its objectives. For section 43 to be fully implemented and enforced, the following changes to the identified provisions could clarify FTC's authority and provide flexibility for more effective enforcement.

Disclosure provisions: FTC staff are apprehensive about the Commission's ability to carry out this mandate, primarily because of how they interpret the risk disclosure requirement, an interpretation that contemplates a discussion of the financial health of a depository institution and its private insurer. Giving FTC the flexibility to determine what disclosure requirements should be issued and to decide on the appropriate means for enforcing them could help to alleviate the Commission's concern. For example, the Commission might choose to require nonfederally insured institutions to obtain independent certifications from state supervisors or another independent body that their institution is in compliance with the section's disclosure requirements. Also, the Commission could be given authority to coordinate with state supervisors of nonfederally insured credit unions to assist in enforcing the disclosure requirements or imposing sanctions for violations of the disclosure provisions.

In addition, a requirement that FTC consult with FDIC and NCUA about disclosure requirements could ensure that disclosure under section 43 covers FDIC and NCUA concerns about the potential for confusion of private deposit insurance with federal deposit insurance, and provides FTC with access to expertise it deems necessary to establish disclosure requirements. Requiring assistance from FDIC and NCUA in fashioning an appropriate disclosure regime may help satisfy FTC concerns about its lack of expertise. Additionally, such assistance would provide the federal deposit insurance agencies with an opportunity to ensure that disclosures adequately inform depositors in a manner that reduces the possibility of confusion with federal deposit insurance and apprises them of the risks associated with the lack of federal deposit insurance.

Shut-down provision: Several aspects of this provision raise regulatory concerns. First, the requirement relies upon states to make a determination that involves federal policies; specifically, whether a particular institution is eligible for federal deposit insurance. The eligibility determination includes many factors that federal regulators apply on a case-by-case basis. A related concern is that the provision does not indicate what criteria a state should use in determining that an institution is eligible for federal deposit insurance. In addition, the section calls upon FTC to shut down institutions that are subject to regulation by state or federal bodies that have expertise in assessing the consequences of a shut down as well as shutting down an institution. To address these concerns, modifications to the shut-down provision could require coordination between FTC and the appropriate primary regulator of an institution in connection with a state's determination of deposit insurance eligibility, the Commission's determination of an institution's eligibility for an exemption from the provision, and the shutting down of an institution.

Annual audit requirements: Section 43 clearly sets forth the requirements for a private deposit insurer with respect to the annual audit it must obtain and to whom the annual audit must be provided. However, the section does not indicate the extent of FTC review and monitoring appropriate for enforcing the provision. In this regard, an amendment to section 43 could provide FTC with specific authority to establish annual audit requirements for private insurers. With such authority, the Commission could set forth the conditions under which it would rely on the annual audit or could enter into a cooperative arrangement with the insurer's state regulators concerning reviews of the annual audit.

Conclusions

Depository institutions lacking federal deposit insurance are chartered and supervised by states; however, the activities of these entities involve federal interests. Congress acted on these federal interests by enacting section 43 of the FDI Act. However, issues of enforcement remain. Consistent with a prohibition in FTC's appropriations authority, the Commission has not enforced section 43 provisions. Absent enforcement, our work showed that compliance with these provisions varied significantly.

Our primary concern, resulting from the lack of enforcement of section 43 provisions, is the possibility that members of state-chartered, privately insured credit unions may not be adequately informed that their deposits are not federally insured and should their institution fail, the federal government does not guarantee that they will get their money back. The fact that many privately insured credit unions we visited did not conspicuously disclose that the institution was not federally insured, raises concerns that the congressional interest in this regard is not being fully satisfied.

The lack of enforcement of the other two provisions—shut-down and annual audit—may have a less direct impact on consumers. While it appears that privately insured credit unions have not obtained a determination from their state regulators that they are eligible for federal deposit insurance, this determination may not be a meaningful protection for consumers. Since it is only a one-time requirement, it does not provide any assurance that institutions will continue to operate in a manner to remain eligible for federal deposit insurance. However, state regulators imposed safety and soundness standards for credit unions lacking federal deposit insurance that are similar to federal oversight standards. NCUA officials also may consider other factors when determining eligibility. ASI officials also told us that they rigorously monitor the safety and soundness of their insured institutions. Given the related actions undertaken to help ensure the health of privately insured credit unions, the effect on consumers from the lack of enforcement of this provision may be negligible. Since we found that the remaining private deposit insurer has complied with the annual audit requirements, state regulators and the management of privately insured credit unions have had the opportunity to become informed about the financial condition of this private deposit insurer. Implementation of this provision helps ensure the safety and soundness of ASI—which, in turn, helps to ensure that members of state-chartered, privately insured credit unions have a viable insurer should their credit union fail. Since the remaining private deposit insurer complied with section 43 audit requirements, it appears consumers suffered no negative impact from the nonenforcement of this provision.

In evaluating which federal agency should enforce these provisions, we found the responsibilities outlined in these provisions did not fall ideally within any single agency's jurisdiction. FTC staff and officials from NCUA and FDIC opposed charging their agencies with this responsibility. NCUA and FDIC both have an interest in making sure that consumers receive adequate information about whether or not their deposits are federally insured. NCUA and FDIC also have considerable expertise in disclosures at federally insured depository institutions. However, FDIC insures the deposits at banks and savings associations—but does not regulate or supervise credit unions or insure deposits at these institutions. If either FDIC or NCUA were charged with this responsibility, it could create potential confusion about federal deposit insurance and would result in a regulatory conflict of interest that could expose the credit union system to a loss of public confidence in the federal deposit insurance system. This would be inconsistent with a central purpose of the provision. Despite this conflict, the agency that enforces section 43 would benefit from coordination with NCUA and FDIC, because of their interests and expertise.

Partnering with state regulators could also help FTC enforce certain section 43 requirements. For example, the Commission might choose to require nonfederally insured institutions to obtain independent certifications that their institution is in compliance with the section's disclosure requirements and that the risks of not having federal deposit insurance have been adequately disclosed. Considering that Congress deferred to the states on whether to permit the operation of depository institutions lacking federal deposit insurance, it is reasonable to conclude that Congress also relied upon the states to oversee the safety and soundness of those institutions and, accordingly, the risks to consumers of dealing with them.

Although institutions lacking federal deposit insurance are chartered and regulated by the states, protecting consumers from confusion about the insurance of their deposits is consistent with the FTC's consumer protection mission. Congress also determined that the federal agency specifically charged with protecting consumers against misleading or deceptive information practices—FTC—should ensure that the federal interest in proper disclosure is maintained. However, Congress has also prohibited FTC from discharging its responsibilities under section 43. While FTC staff has raised jurisdictional concerns, as well as practical concerns about the Commission's ability to enforce these provisions, we believe that these interests can be best addressed by retaining FTC's responsibility for enforcing and implementing section 43. However, the section could be modified to reduce concerns FTC has expressed about its ability to enforce these provisions. Such modifications could allow FTC flexibility in discharging its responsibilities and enable it to call upon the expertise of the federal deposit insurers, state regulators, or others when the Commission deems it necessary without sacrificing the purposes of the section.

Matters for Congressional Consideration

No federal agency was the clear or obvious choice to carry out the responsibilities outlined in section 43 of the FDI Act; however, if modifications were made to these provisions, we believe that FTC would be best suited to retain responsibility for enforcing and administering these provisions. If Congress determines that FTC is the appropriate agency, then Congress should remove the prohibition from FTC using appropriated funds to enforce these provisions. Also, Congress should clarify that FTC's authority to implement and enforce section 43 is not subject to any limitations on its jurisdiction contained in the FTC Act.

To remove obstacles and provide additional flexibility for FTC's enforcement of section 43 disclosure requirements, Congress may wish to consider

- Providing FTC the authority to consult with FDIC and NCUA when determining the manner and content of disclosure requirements to (1) provide FTC with access to expertise it deems necessary to establish disclosure requirements and (2) ensure that the required disclosures address FDIC and NCUA concerns about the potential for confusion of private deposit insurance with federal deposit insurance;
- Providing FTC the authority to coordinate with state supervisors of nonfederally insured depository institutions to assist in enforcing the disclosure requirements; and
- Providing FTC authority to impose sanctions for violations of the disclosure provisions.

To remove obstacles and provide additional flexibility for FTC's enforcement of the section 43 shut-down provision, Congress may wish to consider

- Requiring coordination between FTC and the appropriate primary regulator of an institution when (1) FTC considers whether to exempt an institution from the requirement to obtain a state determination that it meets eligibility requirements for federal deposit insurance; and (2) FTC seeks to shut down an institution because it has not obtained a state determination that it meets eligibility requirements for federal deposit insurance.

In light of some uncertainty as to the scope of FTC's jurisdiction under the FTC Act to regulate insurance entities in matters other than antitrust, Congress may wish to consider clarifying FTC's authority regarding the annual audit provision by

- Providing FTC with specific authority to establish requirements, such as attestation requirements, to ensure the reliability of annual audits for private insurers.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the heads, or their designees, of the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Federal Trade Commission. We received written comments from NCUA and FTC that are summarized below and reprinted in appendixes III and IV respectively. In addition, we received oral comments from the Deputy Director of Supervision and Consumer Protection at FDIC that are summarized below. We also received technical comments from NCUA and FTC that we incorporated into the report as appropriate.

FDIC oral comments focused on the findings in the report dealing with FDIC and the overall report conclusions. FDIC generally agreed with the report's findings dealing with FDIC and stated that the arguments included in the report against having the FDIC enforce section 43 were generally consistent with arguments it provided to congressional staff during the drafting of the Federal Deposit Insurance Corporation Improvement Act of 1991, which led to the decision in the enacted legislation to assign FTC responsibility for enforcing compliance with the provisions discussed in this report. FDIC also stated that while time did not permit it to conduct an exhaustive legal review, it generally agreed with the report's overall conclusions.

NCUA concurred with the report's conclusions that there is a need for enforcement of the consumer protection provisions in section 43 and that, for the reasons stated in our report, FTC, not NCUA or FDIC, is in the best position to enforce these provisions. NCUA also commented on FTC staff concerns expressed in this report that FTC might be challenged if it were to take action against credit unions because its enabling legislation has been interpreted to mean that it has no jurisdiction over nonprofit entities, such as credit unions. NCUA agreed with our conclusion that even if FTC's authority under the FTC Act did not extend to nonprofit entities, the FTC Act did not preclude Congress from subjecting credit unions to FTC's authority under section 43. Although NCUA agreed with this logic, it also believed that under FTC's enabling legislation FTC has jurisdiction over state-chartered credit unions.

FTC disagreed with our conclusion that the Commission is the best among federal agencies to enforce section 43 provisions. FTC believed that the solution we offered does not meet the objectives of the statute and conflicted with our analyses. FTC stated that three principal objectives of section 43 are to provide some federal oversight to determine (1) the safety of deposits in institutions that are neither supervised nor insured by the federal government; (2) the financial soundness of those institutions and their state-supervised insurers; and (3) that disclosures to depositors at those depository institutions "fully inform" the depositors about an institution's lack of federal deposit insurance. We believe that FTC's interpretation of section 43 is inconsistent with the overall framework and purpose of the section.

The regulatory scheme of section 43 indicates that Congress did not intend FTC to have a safety and soundness role. For example, Congress relied upon the states to determine whether a depository institution is eligible for federal deposit insurance even though the determination includes an assessment of an institution's safety and soundness. In addition, Congress required private deposit insurers to obtain an annual audit that satisfies certain standards, but did not require that the insurer submit the audit to FTC. Instead, section 43 requires the insurer to submit the audit to the state supervisors of institutions who have deposits insured by the entity. Finally, Congress' designation of FTC as the federal agency responsible for enforcing section 43 indicates that Congress did not contemplate a federal safety and soundness role. The legislative history of section 43 supports this interpretation. The Senate bill containing the original version of section 43 set forth substantially the same disclosure requirements as are contained in section 43.[81] The bill designated FDIC

[81] S. 543 102d Cong. § 227 (1991) § 227 (137 Cong. Rec. S 16534 (Nov. 13, 1991)).

and NCUA—two safety and soundness regulators—to enforce those requirements. However, in the next version of the bill, which added the audit requirement, the shut-down provision, and the look-alike provision, Congress substituted FTC as the agency charged with enforcement responsibility.[82] The legislative history does not discuss the reasons for this change, but it is reasonable to conclude that by substituting FTC for the safety and soundness regulators, Congress opted against a federal safety and soundness role under section 43. Neither section 43 nor its legislative history indicate that Congress intended to transform FTC from a consumer protection agency into a safety and soundness regulator of state-supervised depository institutions and their state-supervised private deposit insurers.

We believe that the primary objectives of section 43 are to ensure that consumers are protected by receiving the disclosures and opportunity for acknowledgement specified in the section; the performance of an annual audit of the deposit insurer in accordance with generally accepted accounting standards that attests to the insurer's adherence to generally accepted accounting principles and the sufficiency of the insurer's loss reserve; the state certification relating to the shut down provision; and FTC's prudent and reasoned exercise of its authority pursuant to the look-alike provision. Our proposed solutions are consistent with this interpretation of section 43.

FTC also raised concerns about our proposal that the Commission rely in part on NCUA and FDIC in connection with establishing disclosure requirements. FTC said that this recommendation would expose the Commission's formulation of disclosure requirements to the regulatory conflict of interest that would arise if NCUA and FDIC were to have primary regulatory responsibility under section 43. We believe that FTC, as a disinterest regulator with primary responsibility in this area, could neutralize any potential conflict of interest by considering the views of all parties having an interest in or expertise regarding an FTC action under section 43.

FTC also contended that we "significantly overestimate" the Commission's expertise and experience in auditing, deposit safety and reserves, insurance regulation, assessment of financial soundness of depository

[82] S. 543 102d Cong. § 227 (1991) § 227 (137 Cong. Rec. S 17478 (Nov. 21, 1991)).

institutions or insurers, and shutting down depository institutions. The Commission asserted that proper implementation of section 43 "would require grafting onto the FTC, a very small agency, an entirely new deposit safety mission requiring expertise, tools, and resources that the FTC lacks and for which it has no other need." We disagree. This criticism is based on FTC's extreme view of the federal role under section 43. FTC assumes that Congress intended to transform the Commission into a regulator of depository institutions and insurers even though section 43 clearly contemplates that the states are to serve in that capacity. As stated above, we believe that section 43 calls for a more moderate role consistent with FTC's mission as a consumer protection agency.

Congress has charged FTC with disclosure-related responsibilities with respect to many industries that FTC does not regulate. FTC regulates advertising and labeling with respect to a wide variety of consumer commodities and services, yet the Commission does not appear to have expertise in the intricacies of all industries subject to those authorities. Nothing in section 43 calls for FTC to have expertise, experience, or resources to regulate the safety of depository institutions.[83] Also, nothing in section 43 requires FTC to oversee the closure of an institution subject to the shut-down provision. The shut-down provision is self-activating, that is, it is a directive to nonfederally insured depository institutions that they must cease doing business (in interstate commerce), if they have not received an insurance eligibility determination from the state. Congress did not provide any procedure for the institutions to follow when shutting down, and Congress did not charge FTC with responsibility for administering a procedure. It should be noted that FTC has ample experience under its routine enforcement authority in having businesses shut down.

Additional FTC criticisms were that the report overstates the disadvantages and ignores the advantages of NCUA implementing section 43, and that the report does not consider possible alternative assignments of responsibility. FTC's assertions about the efficiency of NCUA regulation are misguided. As we discussed in the report, assigning NCUA the responsibility for regulating its competition would present an inherent conflict of interest that could undermine NCUA's credibility as a regulator.

[83] We question FTC's assertion that it lacks auditing expertise. FTC's operating manual provides that accountants in the Commission's Bureau of Competition "are available to assist all Commission staff . . . and that staff should consider obtaining the services of an accountant in a wide range of situations . . . ."

Moreover, bringing nonfederally insured institutions within the umbrella of regulation by a federal deposit insurer is inconsistent with a central purpose of section 43, which is to ensure the separation of nonfederally insured institutions and their private deposit insurer from federal deposit insurance. The report does not discuss the potential for federal regulators other than NCUA, FDIC and FTC to implement section 43 because no other federal regulator appears to be a suitable candidate. Unlike FTC, the Federal Reserve Board has safety and soundness and related responsibilities regarding certain depository institutions. Placing section 43 responsibilities under the Board would subject nonfederally insured, state-supervised institutions to regulation by a federal supervisor of financial depository institutions. We believe that Congress, by selecting FTC to administer and enforce section 43, sought to avoid such a relationship. FTC administration of section 43 would not necessarily have the same effect.

With respect to SEC, we note that requiring SEC to administer the section would unnecessarily expand the Commission's mission. In some cases a look-alike institution (an entity that takes deposits but which is not chartered as a depository institution) could be involved in a securities violation, in which case SEC could take action under the federal securities laws and would not need authority under section 43 to proceed against an entity. Charging SEC with responsibility under section 43 could blur the distinction between disclosure and audit obligations under the securities laws and those established under section 43. We note, however, FTC is not precluded from working with SEC should FTC invoke the look-alike authority.

FTC also stated that we failed to assess the potential impact on consumers if the disclosure provisions are not enforced. An empirical analysis of the impact on consumers was not performed. Presumably, depositors would not be impacted negatively by the lack of disclosure unless (a) they believed that their deposits were federally insured because of the lack of disclosure; (b) the institution holding their deposits failed; and (c) their deposits were not protected—that is, the deposits were not insured or the insurer was unable to repay the deposits of a failed institution. We note, however, that in section 43 Congress made the judgment that depositors should receive the disclosure required in that section. It is reasonable to conclude that some individuals who do not receive the benefit of that disclosure may be uncertain about the insured status of their accounts.

We agree with FTC's concerns that if the section 43 enforcement authority were immediately activated a number of institutions would be faced with shutting down because they have not obtained determinations from their state supervisors of eligibility for federal insurance and that some institutions would be subject to sanctions because of disclosure failures. We anticipate that Congress would grant FTC discretion to enforce and implement section 43 and, if necessary, to provide for a phased-in approach to deal with FTC's concerns.

We will provide copies of this report to the Chairman and the Ranking Minority Member on the Senate Committee on Banking, Housing, and Urban Affairs, and the Chairman and the Ranking Minority Member on the House Committee on Financial Services. Copies of this report also will be provided to the Chairman of FTC; the Chairman of FDIC; the Chairman of NCUA, and other interested parties. Copies will also be made available to others upon request. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

This report was prepared under the direction of Debra R. Johnson, Assistant Director. Please contact Ms. Johnson or me at (202) 512-8678 if you or your staff have any questions about this report. Other major contributors are acknowledged in appendix V.

Richard J. Hillman
Director, Financial Markets and Community Investment

List of Congressional Committees

The Honorable Ted Stevens
Chairman
The Honorable Robert C. Byrd
Ranking Minority Member
Committee on Appropriations
United States Senate

The Honorable Judd Gregg
Chairman
The Honorable Ernest Hollings
Ranking Minority Member
Committee on Appropriations
Subcommittee on Commerce, Justice, State, and the Judiciary
United States Senate

The Honorable C.W. Bill Young
Chairman
The Honorable David R. Obey
Ranking Minority Member
Committee on Appropriations
House of Representatives

The Honorable Frank R. Wolf
Chairman
The Honorable Jose E. Serrano
Ranking Minority Member
Committee on Appropriations
Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies
House of Representatives

Appendix I: Objectives, Scope, and Methodology

To respond to a mandate in the Conference Report to accompany the House Joint Resolution 2, for the Fiscal Year 2003 Consolidated Appropriations Act—which directed us to study the enforcement of section 43 of the Federal Deposit Insurance Act—we (1) determined the current status of enforcement of these requirements; (2) determined the extent of compliance with each requirement and the potential impact on consumers if these requirements were not enforced, and (3) evaluated which federal agency could most effectively enforce section 43.[1]

To better understand the issues around deposit insurance, we reviewed and analyzed relevant studies on federal and private deposit insurers for both credit unions and other depository institutions. In addition, we interviewed officials at the National Credit Union Administration (NCUA), the Department of the Treasury, and the Federal Deposit Insurance Corporation (FDIC) to obtain perspectives specific to federal and private deposit insurance. We also obtained views from credit union industry groups including the National Association of Federal Credit Unions, National Association of State Credit Union Supervisors, and Credit Union National Association, Inc. (CUNA).

We limited our assessment of "depository institutions lacking federal deposit insurance" to state-chartered credit unions that purchase private deposit insurance because banks, thrifts, and federally chartered credit unions generally are required to purchase federal deposit insurance.[2] As of December 2002, 214 state-chartered credit unions lacked federal deposit insurance, and all but two were privately insured. In addition, our analysis was limited to primary deposit insurance.

To determine the extent to which private deposit insurance is permitted and utilized by state-chartered credit unions, we conducted a survey of state credit union regulators in all 50 states. Our survey had a 100-percent response rate. In addition to the survey, we obtained and analyzed financial and membership data of privately insured credit unions from a variety of sources (NCUA, Credit Union Insurance Corporation of Maryland, CUNA, and American Share Insurance (ASI), the only remaining provider of primary share insurance). We found this universe difficult to

[1] Conference Report to accompany the House Joint Resolution 2, Fiscal Year 2003 Consolidated Appropriations Act, Enforcement of section 151 of FDICIA.

[2] Credit unions are nonprofit cooperatives that serve their members by accepting deposits, making loans, and providing various other financial services.

confirm because in our discussions with state regulators, NCUA, and ASI officials, and our review of state laws, we identified other states that could permit credit unions to purchase private deposit insurance.

To determine the regulatory differences between privately insured credit unions and federally insured state-chartered credit unions, we identified and analyzed statutes and regulations related to deposit insurance at the state and federal levels.[3] In addition, we interviewed officials at NCUA and conducted interviews with officials at the state credit union regulatory agencies from Alabama, California, Idaho, Indiana, Illinois, Maryland, Nevada, New Hampshire, and Ohio.

To determine the extent to which privately insured credit unions met federal disclosure requirements, we identified and analyzed federal consumer disclosure provisions in section 43 of the Federal Deposit Insurance Act, as amended, and conducted unannounced site visits to 57 privately insured credit unions (49 main and 8 branch locations) in Alabama, California, Illinois, Indiana, and Ohio.[4] The credit union locations were selected based on a convenience sample using state and city location coupled with random selection of main or branch locations within each city. About 90 percent of the locations we visited were the main institution rather than a branch institution. This decision was based on the assumption that if the main locations were not in compliance, then the branch locations would probably not be in compliance either. Although neither these site visits, nor the findings they produced, render a statistically valid sample of all possible main and branch locations of privately insured credit unions necessary in order to determine the "extent" of compliance, we believe that what we found is robust enough, both in the aggregate and within each state, to raise concern about lack of disclosure in privately insured credit unions. During each site visit, using a systematic check sheet, we noted whether or not the credit union had conspicuously displayed the fact that the institution was not federally insured (on signs or stickers, for example).

In addition, from these same 57 sites visited, we collected a total of 227 credit union documents that we analyzed for disclosure compliance. While section 43 requires depository institutions lacking federal deposit

[3] We limited our analysis to those states with privately insured credit unions—Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, and Ohio.

[4] 12 U.S.C. § 1831t.

insurance to disclose they are not federally insured in personal documents, such as periodic statements, we did not collect them. We also conducted an analysis of the Web sites of 78 privately insured credit unions, in all eight states where credit unions are privately insured, to determine whether disclosures required by section 43 were included. To identify these Web sites, we conducted a Web search. We attempted to locate Web sites for all 212 privately insured credit unions; however, we were able to only identify 78 Web sites. We analyzed all Web sites identified. Finally, we interviewed FTC staff to understand their role in enforcement of requirements of section 43 for depository institutions lacking federal deposit insurance.

To understand how private deposit insurers operate, we conducted interviews with officials at three private deposit insurers for credit unions—ASI (Ohio), Credit Union Insurance Corporation (Maryland), and Massachusetts Credit Union Share Insurance Corporation (Massachusetts). Because ASI was the only fully operating provider of private primary deposit insurance, ASI was the focus of our review.[5] We obtained documents related to ASI operations such as financial statements and annual audits and analyzed them for the auditor's opinion noting adherence with accounting principles generally accepted in the United States. To determine the extent to which ASI provided copies of its annual audits to state regulators and credit unions it insures, we interviewed state regulators in states where ASI insures credit unions and contacted the management of 26 credit unions that are insured by ASI. Additionally, to understand the state regulatory framework for ASI, we interviewed officials at the Ohio Department of Insurance and Department of Financial Institutions.

To evaluate which federal agency could most effectively enforce these requirements, we interviewed FTC staff and officials from NCUA, FDIC, and various interested industry groups to discuss their perspectives and obtain their positions on enforcement of section 43 requirements. We also conducted legal research and analysis related to these provisions.

[5] As of December 2002, we identified two entities that provide private deposit of primary share insurance to credit unions in the 50 states and the District of Columbia—ASI and Credit Union Insurance Corporation. However, Credit Union Insurance Corporation in Maryland was in the process of dissolution, and therefore we did not include it in our analysis. During our review, we learned that Massachusetts Credit Union Share Insurance Corporation only provides excess deposit insurance, and therefore we did not include it in our analysis.

We conducted our work in Washington, D.C., Alabama, California, Indiana, Illinois, Maryland, Massachusetts, Ohio, and Virginia between February and August 2003, in accordance with generally accepted government auditing standards.

Appendix II: Entities That Enforce Various Laws at Credit Unions

Law	Agency with enforcement authority at credit unions: Federally insured/ federally chartered	Federally insured/ state-chartered	Privately insured/ state-chartered
Credit			
Equal Credit Opportunity	NCUA	FTC	FTC
Electronic Fund Transfers	NCUA	FTC	FTC
Fair Credit Practice Rule	NCUA	FTC	FTC
Consumer Leasing	NCUA	FTC	FTC
Real Estate Settlement Procedures Act	HUD	HUD	HUD
Truth in Lending	NCUA	FTC	FTC
Housing			
Home Mortgage Disclosure Act	NCUA	NCUA	NCUA
Flood Disaster Protection Act	NCUA	NCUA	FHA/VA
Fair Housing Act	HUD	HUD	HUD
Privacy			
Bank Secrecy Act (Currency and Foreign Transactions Reporting Act)[a]	NCUA	NCUA[b]	TREAS
Fair Credit Reporting Act	NCUA	FTC	FTC
Privacy of Consumer Financial Information	NCUA	NCUA	FTC
Credit Union Operations			
Expedited Funds Availability Act	NCUA	NCUA	FRB
Reserve Requirements	FRB	FRB	FRB
Fair Debt Collection Practices Act	NCUA	FTC	FTC
Management Officials Interlocks Act	NCUA	NCUA	DOJ
Truth in Savings Act	NCUA	NCUA	NCUA

Source: NCUA.

Legend:

DOJ Department of Justice
FHA/VA Federal Housing Administration/Veterans Administration
FRB Federal Reserve Board
FTC Federal Trade Commission
HUD Department of Housing and Urban Development
TREAS Treasury Department

Note: Although NCUA is not the primary enforcer under some of these regulations, Title II of the Federal Credit Union Act authorizes NCUA to take cease and desist actions for violations of any law.

[a]The USA PATRIOT Act amended the Bank Secrecy Act, as well as other legislation.

[b]For federally insured credit unions examined by NCUA.

Appendix III: Comments from the National Credit Union Administration

National Credit Union Administration

Office of the Executive Director

August 15, 2003

Richard J. Hillman
Director, Financial Markets and Community Investment
United States General Accounting Office
Washington, D.C. 20548

Re: Proposed Report GAO 03-971.

Dear Mr. Hillman:

On behalf of the National Credit Union Administration (NCUA), we want to thank you for the opportunity to review and comment on your proposed report GA0 03-971, entitled *Federal Deposit Insurance Act [FDIA]: FTC Best Among Candidates to Enforce Consumer Protection Provisions.* Your report concludes that there is a need for enforcement of the consumer protection provisions of the FDIA, noting that many privately insured credit unions do not comply with the disclosure provisions, and that the Federal Trade Commission (FTC), not the NCUA or the Federal Deposit Insurance Corporation (FDIC), is in the best position to enforce these provisions. For the reasons stated in your report, we concur with this conclusion.

The report recommends that Congress provide appropriations to the FTC and consider amending §43 to make it easier for the FTC to carry out its enforcement obligations. The report includes an amendment providing the FTC with explicit authority to consult with the FDIC and NCUA when determining the manner and content of disclosures. In concept, the NCUA supports such an amendment.

Finally, the report indicates that FTC staff believe that the FTC may not be able to take action against credit unions under the current enforcement provision of §43 because it says "[c]ompliance . . . shall be enforced under the FTC Act." 12 U.S.C. §1831t(g). The report characterizes the FTC position as follows:

> The FTC Act, however, limits the [FTC's] jurisdiction in ways that are inconsistent with FTC's responsibilities under section 43. For example, FTC and federal courts have interpreted the FTC Act to mean that the [FTC] has no jurisdiction over non-profit entities, a group that includes credit unions.

Your report concludes that, even if no FTC Act jurisdiction exists, §43 clearly applies to state-chartered credit unions and, as a matter of statutory construction,

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Mr. Richard J. Hillman
August 15, 2003
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any limits on jurisdiction over credit unions in the FTC Act would be superceded by the intent of §43. We agree with the logic of your statutory construction argument, but also believe that the FTC does have FTC Act jurisdiction over state-chartered credit unions and that the statutory construction argument is secondary.

The FTC's jurisdiction under the FTC Act extends to "persons, partnerships, or corporations, except banks, savings and loan(s), . . . and Federal credit unions . . . ." 15 U.S.C. §45(a)(2). The FTC Act defines corporations to include "any . . . association, incorporated or unincorporated, . . . which is organized to carry on business for its own profit *or that of its members*." 15 U.S.C. §44 (emphasis added). While credit unions are organized as nonprofit associations, the purpose of a credit union is to bring financial benefits to its members. The federal courts have recognized the distinction between an entities' organization and its purpose in upholding FTC Act jurisdiction over associations organized as nonprofits but providing financial benefits to members. *See, e.g.,* California Dental Association v. FTC, 128 F.3d 720, 725 (9th Cir. 1997), *rev'd in part on other grounds*, 526 U.S. 756 (1999). Notably, the FTC has previously asserted jurisdiction over state-chartered credit unions while citing the FTC Act as authority. *See, e.g.,* In the Matter of Wright-Patt Credit Union, 106 F.T.C. 354 (1985), and In the Matter of Hospital and Health Services Credit Union, 104 F.T.C. 589 (1984).

Thank you again for the opportunity to comment on the proposed report. If you have any questions or need further information, please contact me at (703) 518-6321.

Sincerely,

J. Leonard Skiles
Executive Director

OGC/PMP:bhs

Appendix IV: Comments from the Federal Trade Commission

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Secretary

August 18, 2003

Mr. Richard J. Hillman
Director, Financial Markets and
Community Investment Issues
US General Accounting Office
441 G Street NW
Washington, DC 20548

Dear Mr. Hillman:

Thank you for the opportunity to comment on your draft report titled *Federal Deposit Insurance Act: FTC Best Among Candidates to Enforce Consumer Protection Provisions* (GAO-03-971)("GAO Report" or "Report"). The following comments note our most pressing objections and comments.

The GAO Report concludes that if Congress made some technical changes to Section 43 of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1831t, and lifted the appropriations ban, there is no reason why the FTC could not enforce it.

We respectfully disagree with the GAO Report's conclusions and recommendations for the following reasons:

(A) The solution that the GAO Report offers does not meet the objectives of the underlying statute and conflicts with the GAO Report's own analyses;

(B) The GAO Report significantly overestimates the ability of the FTC to effectively administer and enforce the requirements of Section 43;

(C) The GAO Report significantly overstates the disadvantages and ignores the advantages of NCUA administration and enforcement of Section 43 as to credit unions, particularly regarding disclosures;

(D) The GAO Report does not assess whether there would be any negative impact on consumers if the disclosure provisions are not enforced and does not assess whether a simple lifting of the appropriations ban requiring immediate compliance with Section 43 would require the shut down of many state or privately insured credit unions; and

(E) The GAO Report does not consider some possible alternative assignments of responsibility for enforcing Section 43.

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August 18, 2003

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The remainder of this letter elaborates on these points. Please be advised that these are only our major concerns; because of the short time we have had to respond to your request for comments, there are others that we may have not addressed at this time.

SUMMARY

In 2002, the Conference Report regarding the FTC's appropriations[1] expressed concern that "the consumer protection intent of" Section 151 of the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"), may be going largely unenforced, and recognized that "the FTC may not be the appropriate Federal agency" to enforce that section. The Conferees directed GAO to study the enforcement of Section 151, to determine the risk to consumers if not enforced, and to make recommendations concerning which federal agency could most effectively enforce the provision.

Section 151 – which became Section 43 of the FDIA as amended – provides the following:

(a) annual audits of private deposit insurers, including assurances of sufficient reserves for losses;

(b) a one-time business plan for private insurers, addressing viability, underwriting standards, resources, and risk management;

(c) disclosures by non-federally insured depository institutions to customers and potential customers, in a variety of circumstances, that the deposits in the institution are not federally insured, sufficient to ensure that the customers understand the risks of forgoing federal insurance; together with a prohibition on accepting deposits from a customer that has not signed an acknowledgment of receipt of the disclosure. The non-federally insured depository institutions are also required to make ongoing disclosures;

(d) a ban on the institution's use of the instrumentalities of interstate commerce (*e.g.*, mails, telephone, and Internet) for facilitating the receipt of deposits, unless the state regulator of the institution has certified that the institution meets all eligibility requirements for federal insurance (the "shut-down" requirement); and

(e) In addition, the section applies not only to depository institutions such as deposit-taking banks, savings associations, and credit unions, but also to entities in the business of receiving deposits that customers could reasonably mistake for a depository institution (the "look-alike" provision).

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[1] Conference Report to Accompany H.J. Res. 2, H.R. Rep. 108-10 at 776 (Feb.13, 2003).

Mr. Richard J. Hillman
August 18, 2003

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Contrary to the GAO Report's conclusion, the FTC is not able to implement and enforce these provisions.

A. GAO's proposed solution will not meet the objectives of the statute.

Three principal objectives of Section 43 described above are to provide some federal oversight to determine: (1) whether deposits in state-regulated depository institutions are safe; (2) whether those state-regulated institutions and the state-regulated insurers of those institutions are financially sound; and (3) whether customers of those institutions are fully informed about their lack of federally-backed deposit insurance.

The GAO Report's recommendations would not achieve these results. The Report's proposals would assign responsibility for implementing and enforcing all these provisions, including creating exceptions to certain requirements, to the FTC, an agency lacking the experience, expertise, regulatory role, and resources needed to address the issues posed by Section 43. The proposal suggests that the FTC compensate for these obvious deficiencies by calling on the expertise and judgment of (a) the state regulators (thus providing no effective federal oversight) or (b) the NCUA and FDIC, despite the GAO Report's finding that conflicts of interest would fatally taint their discretion in these areas. However, if NCUA were assigned enforcement of Section 43, NCUA would presumably specify the required disclosures and exemptions through public rulemaking, with comment from all affected parties and subject to judicial review, thus avoiding an intolerable conflict of interest. The GAO Report reads Section 43 as primarily ministerial and not requiring any expertise. This reading seriously undercuts the purpose of Section 43.

B. GAO significantly overestimates the ability of the FTC to administer and enforce the requirements of the section.

The FTC lacks both expertise and experience in auditing, deposit safety and reserves, insurance regulation, assessment of financial soundness of depository institutions or insurers, and shutting down depository institutions. Moreover, as described below, despite a superficial similarity to FTC responsibilities in other areas, even some of the disclosure provisions of Section 43 reach well beyond anything the FTC is positioned to do, effectively placing the agency in the position of a bank regulator. Proper implementation of Section 43 by the FTC would require grafting onto the FTC, a very small agency, an entirely new deposit safety mission requiring expertise, tools, and resources that the FTC lacks and for which it has no other need.

The GAO Report's conclusion that the FTC could enforce Section 43 rests on GAO's reading most FTC obligations under the section so narrowly as to limit the agency's role to receiving filings. Such an interpretation provides consumers with virtually none of the protections envisioned by the statute. It also renders the FTC's role meaningless. Finally, the modifications to Section 43 that GAO suggests would not resolve any of the profound handicaps to FTC responsibility for the section, as discussed further below. As such, the Report does not

Mr. Richard J. Hillman
August 18, 2003

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present a sound basis to conclude that the FTC could enforce Section 43.

C. The GAO Report significantly overstates the disadvantages and ignores the advantages of NCUA administration and enforcement of the section as to credit unions, particularly regarding disclosures.

The GAO Report expresses concern that assigning to NCUA the responsibility for Section 43, particularly the disclosure requirements, would create an intolerable conflict of interest. This conclusion seems contradicted by the existence of other statutes that assign NCUA the responsibility for enforcing disclosure obligations. Thus, the Congress has accepted, and the NCUA has managed, similar responsibilities under similar laws. In addition, Congress could also prohibit the NCUA from discriminating against non-federally insured entities and their insurers.

The GAO Report, however, does not discuss the efficiency and effectiveness of assigning NCUA responsibility for Section 43. NCUA possesses thorough familiarity with the credit union business and on NCUA's prior promulgation of several disclosure rules closely paralleling or addressing issues relevant to the required disclosures under Section 43.[2] These NCUA rules include disclosures relating to deposit insurance and deposit accounts by non-federally insured credit unions.

Instead, the GAO Report incorrectly concludes that the federal credit union insurance fund would be put at risk because customers would be led to believe their deposits were federally insured simply because the NCUA required disclosures that the deposits were not so insured. It is doubtful that customers would know or care what agency required the disclosure. Moreover, if customers' awareness of federal regulation created expectations of federal insurance, that would likely occur regardless of which federal agency was involved. In any event, NCUA would have the incentive to develop very clear disclosures.

Any concerns that NCUA has about subsidization by federal or federally insured credit unions could be readily resolved, for example, by assessing an appropriate fee from non-federally insured credit unions.

D. The GAO Report does not assess the potential impact on consumers if the disclosure provisions are not enforced.

The GAO Report does not discuss, as requested by the Congress, whether consumers are already sufficiently aware of the lack of federal insurance at non-federally insured credit unions. Although the Report notes several types of disclosures of lack of federal insurance that are made

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[2] *See, e.g.,* 58 Fed. Reg. 50,394 (Sept. 27, 1993)(Regulations promulgated by NCUA under the Truth in Savings Act).

currently, the GAO Report fails to mention that NCUA also currently requires a specific disclosure, in places of business and in advertising, by federally insured credit unions of the fact that they do have federal insurance. The GAO Report does not address whether the absence of such disclosure by a credit union already alerts customers and potential customers to its lack of federal insurance, or the extent to which non-federally insured credit unions communicate this information to their customers by other means.

E. The GAO Report does not consider possible alternative assignments of responsibility.

While the GAO Report suggests amendments to the section, it does not address the basic problem that leads to difficulties in assigning responsibility: that the section reaches several different types of entities that present different concerns and are generally regulated differently. Looking separately at the different types of entities and problems suggests approaches to enforcing the section that may be more viable than the GAO Report's recommendation that the FTC have sole responsibility.

The GAO Report does not address whether its concerns about NCUA conflict of interest or about risk to its insurance funds might be avoided by assigning responsibility for credit unions to the Federal Reserve Board, which has no insurance function, has complete familiarity with depository issues, is accustomed to regulating state-chartered institutions, and has rulemaking experience concerning depository institutions generally.

The GAO Report does not consider whether regulation, exemption, or shut-down of "look-alikes," if deemed necessary, might best be assigned to the SEC, which currently has jurisdiction over and enforcement experience with many of the possible candidates for that designation – such as brokerage houses, mutual funds and the like, and entities such as the Latin Investment Corporation – that were an original focus of Congress' concerns.

FURTHER DISCUSSION

I. THE FTC LACKS EXPERTISE AND EXPERIENCE REQUIRED FOR EFFECTIVE IMPLEMENTATION AND ENFORCEMENT OF SECTION 43.

A. Insurer audit and business plan requirements call for expertise that the FTC lacks.

The insurance audit provision requires each private insurer of a depository institution to provide an audit of the insurer, including a determination that the insurer's loss reserves are sufficient, to depository institutions that they insure and to those institutions' state regulators. This provision allows the depository institution and its regulator to make sure the institution's deposits are adequately protected by the private insurance. The business plan requirement, in Section 43 of FDIA, requires that each private insurer of a depository institution provide an

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initial business plan explaining the viability of the firm and covering such matters as its underwriting standards, resources, and risk management.[3]

Without expertise in auditing, depository institution regulation or risk assessment, or insurance regulation or claim reserves, the FTC is not equipped to determine even the sufficiency of the audits filed, much less to review the adequacy of the insurer's assessment of its viability, underwriting standards, resources and risk management.

The GAO Report suggests that the FTC's only responsibility would be simply the ministerial one of recording whether an insurer has filed with the designated recipients something identified as an audit – that is, an audit without any FTC review of whether it is actually a sufficient audit that was performed with appropriate accounting methods and in accordance with the statutory requirements. Simply noting the receipt of a piece of paper, with no review of the audits' sufficiency even by spot-checks, provides no incentive to maintain safety and soundness of institutions or their insurers.

Unlike the FTC, if a depository institution with private insurance or its state regulator intends to make use of such an audit, each is in a position to ensure that it receives a legitimate audit from the insurer. This is because each can control whether the institution insures with the private insurer, private insurers and state regulators can also assess the sufficiency of the audit based on their expertise.

Providing the state regulator and depository institution with the insurer's audit may provide some protection. Nonetheless, inserting the FTC, an agency with no expertise or role in the regulation of deposits or deposit insurance, into the process of providing depository institutions and their regulators with insurer audits, simply to ensure that a piece of paper is filed -- with no agency consideration of whether the paper meets the statutory requirements -- produces no benefit to consumers and worst of all, may create a false impression that the FTC is providing consumers with more protection than the consumers are actually receiving.

The GAO Report also suggests that the FTC could set conditions for relying on the auditors for the sufficiency of their audits. The FTC has no expertise or background with which to identify any such appropriate conditions. Issues of proper accounting practices have been highly contested over the years and have recently become high visibility, high priority issues for national policymakers. The Enron and Worldcom cases have made clear, if nothing else has, that proper accounting and auditing requires stringent expert oversight. The FTC cannot provide that oversight.

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[3] *See* GAO Report at 43 n.61.

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B. Disclosure requirements call for expertise in depository institution practice and regulation, and implicate depository policies.

Assigning the enforcement of Section 43 disclosure requirements to the FTC undoubtedly would insert the FTC in depository institution regulation and create enforcement problems.

Congress and the public expect regular supervision, inspection, and examination of depository institutions to ensure that deposits are safe. Both federal and state depository supervisors have those powers and procedures; the FTC does not have the examination authority, tools or resources to audit wide-scale compliance with disclosure provisions.

Enforcing the prohibition on taking a deposit without a signed acknowledgment would require halting the acceptance of deposits and returning impermissible deposits to their owners. This can entail complex involvement with the management of an institution, and may weaken an institution to the point of failure and shut-down. Administration of such a provision requires expertise in depository institution shut down procedures and resources that the FTC does not possess.

The GAO Report's solution is to authorize the FTC to call on the expertise of depository institution regulators, though the GAO Report itself objects to assigning the responsibility directly to those regulators due to purported conflicts of interest. Because the FTC has no independent basis for exercising its discretion regarding depository policy, it would need to rely on the regulators and would thus incorporate the very conflicts of interest that the GAO Report has identified.

The GAO Report mistakenly claims as relevant the FTC's role as enforcer of specific credit and privacy laws as to non-federally insured credit unions. In fact, these laws deal with credit unions as lender, lessor, or the like, or as holder of personal information; none has anything to do with deposit insurance, depository law or practices, or the depository function of the institution.

C. The FTC cannot effectively enforce the prohibition on using instrumentalities of interstate commerce (the "shut-down" provision), which applies to depository institutions not certified by their state regulators as eligible for federal insurance, nor can it effectively determine whether to exempt particular institutions.

In short, the statute requires that state chartered depository institutions not meeting the requirements for federal deposit insurance cease accepting deposits and be shut down. The FTC has no experience or expertise in shutting down depository institutions and therefore cannot do so without causing the very type of disruption and loss that Section 43 is intended to avoid. Further, the FTC has no access to funds to avoid disruption and loss when shutting down depository institutions.

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The GAO Report suggests that the FTC would rely on a state certification that an institution meets federal insurance requirements. Further, in the absence of certification, the FTC would determine that the institution could not use the mails, telephone, etc. Moreover, since this determination would effectively require the institution to shut its doors, the state would manage the winding down of the business. In other words, the Report would assign to the FTC a mere requirement of declaring the institution out of business, leaving all other aspects of the matter to the state. This would be a pointless assignment of responsibility to the FTC. In addition, it is unrealistic to believe that the FTC would not have to take action in particular cases to enforce the shut down order.

We have been informed that many state-regulated, privately insured credit unions do not meet all eligibility criteria for federal insurance under Section 43. The FTC would have authority to exempt such institutions from the shut-down provision, but without any statutory criteria or expertise to apply to the determination. Section 43 directs the FTC to consult with the FDIC on the subject, but the FTC would have nothing to contribute to the decision. If, as the GAO Report suggests, the FDIC is fatally tainted by conflict of interest, then the decision would be tainted as well; if not, the decision would be better assigned to the FDIC, as the FTC's involvement would likely be meaningless.

The GAO Report would also give the FTC responsibility for determining the scope of the second prong of the definition of "depository institution" covered by Section 43: the so-called "look-alikes." This is a complex and potentially costly task of determining whether any of the kinds of entities that accept deposits could reasonably be mistaken for depository institutions (for example, the FTC would have to explore potential customers' understanding of money market accounts); imposing and enforcing disclosure requirements; determining whether and on what basis to exempt any such firms from the shut-down provisions; and shutting down any that are not exempted.

II. GAO OBJECTIONS TO NCUA ENFORCEMENT AS TO CREDIT UNIONS ARE NOT WELL FOUNDED.

The NCUA and the FTC are close to the same size (NCUA- 963 FTE's and FTC -1057 FTE's in 2002) and budget (NCUA $133 million and FTC $157 million). The NCUA's mission is solely to regulate fewer than 10,000 credit unions, while the FTC's mission encompasses both antitrust and consumer protection enforcement of over 30 statutes for virtually all U.S. businesses with the exception of banks, common carriers, insurers, and most non-profits. Given the amount of resources apparently necessary to regulate a portion of the depository institutions, the FTC would be unable to meet its other mission requirements if it must enforce Section 43.

A. Avoiding subsidization.

GAO's concern that NCUA responsibility for Section 43 would require federal and federally insured credit unions to subsidize oversight of non-federally insured credit unions could

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be resolved, for example, by imposing a fee for the latter credit unions. Such an approach could also aid in negating any perception of conflict of interest.

B. Relevant NCUA disclosure experience.

Assigning to the NCUA the responsibility for disclosures by privately insured or uninsured credit unions would be highly efficient and effective, both because NCUA is thoroughly familiar with credit union practices, allowing it to make informed decisions about appropriate disclosures and exemptions, and because it has already considered many relevant issues in its previously promulgated disclosure rules:

- The NCUA has issued rules defining the content, manner and form of disclosure, by federally insured credit unions, of the fact that customer deposits do have federal insurance.
- The NCUA has issued rules defining the content, manner and form of disclosure, by federally insured credit unions seeking to leave the federal insurance program, of the fact that, if the change is approved, customers' deposits will not be federally insured or backed by the federal government.
- The NCUA has also issued rules under the Truth-in-Savings Act ("TISA") that apply to non-federally insured credit unions among others, prescribing disclosures to current and prospective customers of important information about their deposit accounts, for the purpose of aiding customers in comparison shopping. In the course of this rulemaking, the NCUA learned that defining the terms, scope, and exemptions from the rules was far more complex and controversial that it had anticipated, requiring extensive familiarity with credit union and depository law and practice.[4]

C. Misplaced concern about conflict of interest.

The GAO Report views NCUA responsibility for Section 43, especially disclosure provisions, as creating an intolerable conflict of interest because NCUA as insurer would be in direct conflict with private insurers. Given existing NCUA responsibilities, however, no new kinds of conflicts would be created.

- Precisely the same direct competition with a private insurer, and thus precisely the same purported conflict of interest issue, arises whenever a state credit union wishes to leave the NCUA insurance program in favor of private insurance. Nonetheless, Congress has entrusted NCUA with control over whether and on

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[4] *See, e.g.,* 58 Fed. Reg. 50,394 (Sept. 27, 1993).

what terms a state credit union can make that change. In particular, NCUA currently regulates and enforces the disclosures that the credit union must make to its members specifically about forgoing federal deposit insurance.

- In addition, as an organization funded by federal credit unions and earnings from the federal insurance fund, NCUA arguably has always had an interest in aiding credit unions with federal charters or insurance, and in discouraging credit unions with state charters and private insurance. Nevertheless, Congress entrusted NCUA with disclosures under TISA by non-federally insured credit unions to their members and prospective members concerning significant facts about their accounts.

  The GAO Report distinguishes TISA, which applies to all credit unions, from Section 43, which only applies to non-federally insured credit unions. Because credit unions with federal insurance must also disclose that fact under separate law, in effect, all credit unions would be required to disclose whether or not they have federal insurance, dispelling the distinction.

- As with its other disclosure rules, if made responsible for Section 43 disclosures, NCUA would presumably specify the required disclosures and exemptions through public rulemaking, with comment from all affected parties and subject to judicial review.

- To avoid any concern that NCUA might adopt an excessively burdensome disclosure requirement, Congress could explicitly prohibit discriminatory conduct by NCUA. Congress could also authorize state enforcement of the disclosure requirement, allowing NCUA and the state credit union regulators to coordinate supervisory oversight, comparable to coordination with respect to state-chartered, federally insured credit unions.

In conclusion, we note that Section 43 was passed in 1991 as one small provision of a massive financial institution reform package. Under GAO's current analysis, as many as half of the privately insured credit unions are not in technical compliance with the statutory

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requirements. The proposal to simply lift the current congressional bar on FTC enforcement would be illadvised for many reasons, including those outlined in this letter.

The Commission appreciates the opportunity to review and comment on GAO's Report.

By direction of the Commission.

Shira Pavis Minton

Shira Pavis Minton
Acting Secretary

Appendix V: GAO Contacts and Staff Acknowledgments

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