MINUTES

MONTANA HOUSE OF REPRESENTATIVES
53rd LEGISLATURE - REGULAR SESSION

COMMITTEE ON BUSINESS & ECONOMIC DEVELOPMENT

Call to Order: By **CHAIRMAN STEVE BENEDICT**, on January 21, 1993, at 9:00 A.M.

ROLL CALL

Members Present:

Rep. Steve Benedict, Chair (R)
Rep. Sonny Hanson, Vice Chair (R)
Rep. Bob Bachini (D)
Rep. Joe Barnett (R)
Rep. Ray Brandewie (R)
Rep. Vicki Cocchiarella (D)
Rep. Fritz Daily (D)
Rep. Tim Dowell (D)
Rep. Alvin Ellis (R)
Rep. Stella Jean Hansen (D)
Rep. Jack Herron (R)
Rep. Dick Knox (R)
Rep. Don Larson (D)
Rep. Norm Mills (R)
Rep. Bob Pavlovich (D)
Rep. Bruce Simon (R)
Rep. Carley Tuss (R)
Rep. Doug Wagner (R)

Members Excused: REP. VICKI COCCHIARELLA

Members Absent: NONE

Staff Present: Paul Verdon, Legislative Council
Claudia Johnson, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing: HB 57, HB 165 AND HB 182
Executive Action: HB 57, HB 165 AND HB 182

HEARING ON HB 57

Opening Statement by Sponsor:

REP. BOB PAVLOVICH, House District 70, Butte, said there are problems with the bill and asked the committee to table HB 57.

Proponents' Testimony:

None

Opponents' Testimony:

None

Informational Testimony:

None

Questions From Committee Members and Responses:

None

Closing by Sponsor:

Rep. Pavlovich closed.

EXECUTIVE ACTION ON HB 57

Motion: **REP. DAILY MOVED HB 57 BE TABLED.**

Discussion: None

Motion/Vote: The question was called. Voice vote was taken. Motion **CARRIED** unanimously.

Vote: **HB 57 BE TABLED.** Motion **CARRIED** 18 - 0.

HEARING ON HB 165

Opening Statement by Sponsor:

REP. DON LARSON, House District 65, Seeley, said HB 165 defines additional terms regarding liquefied petroleum products, and specifying unlawful acts providing for the county attorney to prosecute violations, providing a penalty, and providing for owner identification on liquefied petroleum product containers. He said HB 165 specifies and clarifies the ownership of propane tanks, and requires that only the owner will fill the tank.

Proponents' Testimony:

Ronna Alexander, representing the Montana/Wyoming Propane Gas Association, said the association consists primarily of retail marketers of liquified petroleum or (LPG). **Ms. Alexander** said HB 165 includes the distribution and transportation of LPG, and those that sell LPG appliances. There are currently 90 members in the Montana group, which is the majority of retail dealers in

the state. She explained the "Container Law". She said LPG containers are generally leased to homeowners and businesses, they are over 110 gallons, and used for heating, cooking, etc. She said there are positive reasons for the Container Law. The primary reason is for safety. The industries that have experienced this, have demonstrated that it is necessary for one person to be responsible for filling a tank, because it involves more than just specifying what person is qualified to fill one. The LPG container is an integral part of a pressurized fill system, if it is filled incorrectly or damaged when being filled, or filled with a contaminated product, it is possible for a serious accident to occur and result in serious damage. She said having the same company fill the tanks that own the tanks, will insure the safe distribution of the product. There are federal regulations that are involved which deal with the Occupational, Health and Safety Administration (OSHA), and have established tank ownership rules. **Ms. Alexander** said in addition, the U.S. Consumer Product Safety Commission and the National Association of State Fire Marshals have endorsed the established tank ownership rules. She said the regulations are based on the fact that the tank's owner is responsible for the condition of the tank, and only the owner or authorized agent can be counted on to use the safety precautions necessary when filling the tank, and inspecting the tanks each time they are filled. Industry standards and federal rules hold the tank owner accountable for the condition of the containers and the suitability for service. **Ms. Alexander** explained the need for state law when there are federal regulations already in place. She said as in most cases, federal rules apply only to interstate commerce. State agencies that regulate the transporting of LPG do follow the federal standards and rules, but there is always a gap in regulatory enforcement process. If there is a state law, Montana will not be dependent on the federal regulations or affected by the changes in them. **SEE EXHIBIT 1**

Gary South, Regulation compliance manager with Northern Energy, said they are a retail propane marketer with 95 locations operating in 12 states. He said Northern Energy supports the proposed bill with the importance that such a law is for consumer safety. When an LPG container is filled with gas by a person other than the owner or without the owner's authorization, it will prevent the liability to be placed on the owner of the container. The container law has been drafted with respect to ASME containers which are stationary containers set at the residential or commercial locations, for the use of heating, water heating and cooking. This bill was not proposed to restrict the filling of DOT ICC cylinders which are the portable cylinders in recreational vehicles and BBQs. The portable ICC cylinder is sold to the consumer giving them ownership and the ability to choose which propane marketer will fill their cylinders. He said there are 27 states that currently have a container law, and 23 states that don't. However, 39% of those that don't have container laws, have drafted similar laws that are before the committee today.

Daryl South, owner and operator of Montana Propane, Helena, said he supports HB 165 for the safety aspect it allows the retailers to maintain in their industry. He said safety is in the forefront, i.e., if an accident occurs, it is too late to say "we should have done this or that". He gave an example of what his company does before they leave the residence; there has been a safety gas check, lines have been pressure checked, all appliances have been checked for proper venting to make sure the safety valves are in proper operating fashion, and at that point on, the company starts monitoring the daily use of the customer. If someone else came along and filled their tank, i.e., the tank ran out of gas and they had another company come in to fill the tank, they may not know that the customer has a gas range and the pilot lights have gone out; if no one is at home to check on the pilots, gas will escape into the house and cause serious damage. With the tank belonging to his company, they would assume the liability on those damages. He urged the committee to support HB 165.

Opponents' Testimony:

None

Informational Testimony:

None

Questions From Committee Members and Responses:

Rep. Ellis asked if a resident owns their own tank, who assumes the liability when there are several companies that fill the tanks? **Daryl South** said when a tank is owned by an individual, anyone can fill the tank.

Rep. Sonny Hanson asked **Daryl South** if there were companies that leased tanks, but do not sell LPG. **Mr. South** said most companies that lease propane tanks do supply petroleum products. **Rep. Hanson** said this bill seems to be a protection for distributors of LPG, i.e., if someone down the road sells LPG for 2¢ less, the residence or commercial place will not be able to change to that lower priced company because of the current lease, is this not true? **Mr. South** said he just started his small business in Montana, and it would be easier for him to go around and fill everyone's tank. **Mr. South** said the resident is not locked in, they can change over to any company they want. **Rep. Sonny Hanson** asked if this bill could be replaced by a lease agreement with a clause inserted to read, "a resident could not buy propane from anyone else, because the tank belongs to a specific company"? He asked **Mr. South** if they could go on that same basis and accomplish the same thing? **Mr. South** said all leases are written this way, but basically do not have any teeth in them, therefore, the reason for the bill.

Rep. Barnett asked **Rep. Larson** about page 4, subsection 4, line 8 - 13, where it states that the county attorney will prosecute, is there a fiscal impact statement, and what kind of a burden will this place on the county attorney's office? **Rep. Larson** said they did not feel there would be a fiscal impact on the bill.

Closing by Sponsor:

Rep. Larson closed stating there are three issues involved with HB 165; 1) public safety; 2) liability of the owner; and 3) consumer safety. He said the propane company is supposed to notify the owner of the tank, and if there is a deficiency in that tank, they are not to fill that tank. He said HB 165 clarifies who is responsible for the tank, and urged a do pass recommendation.

HEARING ON HB 182

Opening Statement by Sponsor:

REP. BOB BACHINI, House District 14, Havre, said HB 182 revises the laws relating to central credit unions, and changing the terminology from "central" to "corporate" credit unions. He said HB 182 is before the committee because of federal mandates.

Proponents' Testimony:

Bob Pyfer, Montana Credit Unions League, said the league represents 90 of Montana's 94 natural person credit unions. Credit unions are not-for-profit, non-stock consumer financial cooperatives. They are owned and controlled by its user-members through a one-member, one-vote process, whereby, the board of directors is elected, and all board and committee members are uncompensated volunteers. He said this bill relates to a special kind of credit union, called a corporate credit union. A corporate credit union is the credit union of credit unions. Other credit unions can become members of the corporate credit union, then the member credit union can borrow from the corporate credit union if necessary, and invest excess funds with the corporate credit union. The corporate credit union may also provide it's members with other types of financial services, such as correspondence check collection, and automated funds transfer services. He said there is only one corporate credit union in Montana which is Treasure State Corporate Central Credit Union, and is located in Helena. Treasure State Corporate is a state-chartered credit union and is subject to the state laws on credit unions. This bill amends those laws and brings them into conformance with the new federal regulations, thereby, bringing Treasure State into conformance with the federal regulation. Without these amendments, Treasure State would be required or forced to change their charter to convert to a federally-chartered credit union. A state regulator is closer to home, more accessible and knowledgeable of the special problems of the local economy in Montana. He read the purpose of the bill, the

methodology of the bill as drafted, and went through the bill on a section by section analysis. The methodology of the bill is in response to a federal mandate. He said it would be easiest to incorporate federal law by reference in saying all state-charted credit unions shall fully comply with Title 12, but there are court cases in Montana that would declare such an incorporation by reference an unconstitutional delegation of legislative authority to the federal government. **SEE EXHIBIT 2, 2a and 2b.**

Myrtle White, Vice President, Financial Services Montana Credit Union League, Chief Operating Officer of Treasure State Corporate Central Credit Union, gave testimony on Treasure State Corporate Central Credit Union, their position and its services. She read written testimony. **EXHIBIT 3**

Larry Heggen, President of Laurel Federal Credit Union, Laurel, said for all the reasons above he supported HB 182, and urged the committee for a do pass recommendation.

Gene Bowen, President of Helena Community Federal Credit Union, Helena, urged the committee's support for HB 182.

Opponents' Testimony:

None

Informational Testimony:

None

Questions From Committee Members and Responses:

Rep. Knox asked **Bob Pyfer** about the list that he referred to in his testimony if the rates on the assets are based on a degree of risk? **Mr. Pyfer** said that is correct. **Rep. Knox** asked what criteria was being used and who is doing the rating? **Mr. Pyfer** said the National Credit Union Administration (NCUA) does the rating. He said it is a lengthy schedule that goes through and lists all the various types of assets ranging from coin and currency up to unsecured bonds. It attaches a percentage rate of the total assets that is reserved against them, and sets a reserving factor that has to be applied to come up with the dollar amount. **Rep. Knox** asked if this is an internal process? **Mr. Pyfer** said that is correct in terms of the regulatory system, but NCUA makes those decisions under the Federal Credit Union Act, who is required and authorized to make those decisions. He said they may look at other industries' rating process.

Rep. Sonny Hanson asked **Myrtle White** if they were developing terms based on percentage of income, and are they now setting a percentage on the assets. He said it looks like the reserves are based on their loans, now the financier of the local credit unions will have to have input on the conditions of their own portfolio so the Corporate Federal union can evaluate them. **Ms.**

White said in a normal financial institution the bulk of the assets will be loaned, i.e., to the credit union members, but with a corporate credit union this is not true. Back in 1977 there was a credit crunch, people were borrowing and credit unions needed to borrow; currently, there are very few loans to credit unions. She said at year's end the $159 million worth of assets of the Treasure State, they had loaned only $5 million to credit unions. She said that most all credit unions have the ability to withdraw remotely from their account.

Rep. Sonny Hanson asked **Paul Verdon, Legislative Council** if the committee approves the bill, are they approving the statement of intent or does the committee have to address this separately. **Mr. Verdon** said the statement of intent is part of the bill. He said the committee can amend the bill to strike, but cannot take the intent part out.

Rep. Herron asked **Bob Pyfer** to explain the difference between what the credit union is charged for local and federal taxes, and what the banking institutions are charged? **Mr. Pyfer** said there is a difference when it comes to income taxes. Credit unions pay property taxes, but credit unions as non-profit, non-stock member owned cooperatives do not pay income taxes. He said one of the main reasons for the credit unions' tax exemptions, which is a matter of federal law combined with the state aid act together. He said the most important reason for this, is the capital structure. They cannot issue "at-risk capital stock" to support a natural person credit union like a bank can. This means that the only way they can build capital as a natural person credit union is with their earnings. Capital is essential these days after the S & L disaster. If their incomes were taxed, they would have to borrow "at-risk capital stock" which would destroy the one-member, one-vote concept.

Closing by Sponsor:

Rep. Bachini closed urging a do pass recommendation.

EXECUTIVE ACTION ON HB 165

Motion: **REP. LARSON MOVED HB 165 DO PASS.**

Discussion: **Rep. Sonny Hanson** said he is basically against the bill, because they are trying to find cheap attorneys through the county attorney's office. They want the county to enforce the contracts they have. On page 4, section 4, starting with line 8, it states the county attorney will prosecute violations. He quoted Mr. South, who stated it is currently in their contract now to do this.

Rep. Brandewie said he favors the bill, and understands what **Rep. Sonny Hanson** is trying to say, but felt that part should be taken

out. He did not think the county attorney should be involved in the enforcing of regulation like this.

Rep. Larson said he did not have a problem in striking section 4 in its entirety, and offered to make the motion to strike section 4.

Motion/Vote: **REP. LARSON MOVED TO TO ADOPT AMENDMENT. REP. PAVLOVICH** called the question. Voice vote was taken. Motion **CARRIED** unanimously. **EXHIBIT 4**

Motion/Vote: **REP. SIMON MOVED TO ADOPT AMENDMENT,** by striking subsection 3 on page 4. The question was called. Voice vote was taken. Motion **FAILED** 16 - 2 with **Reps. Simon and Daily** voting yes.

Motion/Vote: **REP. BRANDEWIE MOVED HB 165 DO PASS AS AMENDED.** The question was called. Voice vote was taken. Motion **CARRIED** 15 - 3 with **Reps. Ellis, Sonny Hanson and Mills** voting no.

Vote: **HB 165 DO PASS AS AMENDED.** Motion **CARRIED** 15 - 3.

EXECUTIVE ACTION ON HB 182

Motion: **REP. BACHINI MOVED HB 182 DO PASS.**

Discussion: None

Motion/Vote: **REP. BRANDEWIE** called the question. Voice vote was taken. Motion **CARRIED** unanimously.

Vote: **HB 182 DO PASS.** Motion **CARRIED** 18 - 0.

ADJOURNMENT

Adjournment: 11:15 A.M.

STEVE BENEDICT, Chair

CLAUDIA JOHNSON, Secretary

SB/cj

HOUSE OF REPRESENTATIVES
53RD LEGISLATURE - 1993
BUSINESS AND ECONOMIC DEVELOPMENT COMMITTEE

ROLL CALL DATE 1-21-93

NAME	PRESENT	ABSENT	EXCUSED
REP. ALVIN ELLIS	✓		
REP. DICK KNOX	✓		
REP. NORM MILLS	✓		
REP. JOE BARNETT	✓		
REP. RAY BRANDEWIE	✓		
REP. JACK HERRON	✓		
REP. TIM DOWELL	✓		
REP. CARLEY TUSS	✓		
REP. STELLA JEAN HANSEN	✓		
REP. BOB PAVLOVICH	✓		
REP. VICKI COCCHIARELLA			✓
REP. FRITZ DAILY	✓		
REP. BOB BACHINI	✓		
REP. DON LARSON	✓		
REP. BRUCE SIMON	✓		
REP. DOUG WAGNER	✓		
REP. SONNY HANSON, VICE CHAIRMAN	✓		
REP. STEVE BENEDICT, CHAIRMAN	✓		

HR:1993
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HOUSE STANDING COMMITTEE REPORT

January 21, 1993

Mr. Speaker: We, the committee on Business and Economic Development report that House Bill 165 (first reading copy -- white) do pass as amended .

Signed: _____
Steve Benedict, Chair

And, that such amendments read:

1. Title, lines 6 and 7.
Strike: "PROVIDING FOR THE COUNTY ATTORNEY TO PROSECUTE VIOLATIONS;"

2. Page 4, lines 8 through 14.
Strike: Section 4 in its entirety
Renumber: subsequent sections

3. Page 4, lines 20 and 23.
Strike: "5"
Insert: "4"

HOUSE STANDING COMMITTEE REPORT

January 21, 1993

Mr. Speaker: We, the committee on Business and Economic Development report that House Bill 182 (first reading copy -- white) do pass .

Signed: _____

Steve Benedict, Chair

EXHIBIT 1
DATE 1-21-93
HB 165

MONTANA/WYOMING PROPANE GAS ASSOCIATION

11259 E. VIA LINDA, SUITE 100-104
SCOTTSDALE, ARIZONA 85259

TELEPHONE/FAX
602-661-8904

WHAT IS A "CONTAINER LAW"?

A container law restricts the filling of an LP-gas storage tank, or container, to its owner or someone with his authorization. A typical law states, in part, "An LP-gas container shall be filled only by the owner or upon the owner's authorization.

The need for such a restiction is acknowledged by the U.S. Consumer Product Safety Commission and organizations of safety regulatory officials such as the National Association of State Fire Marshals, among others. In fact, U.S. Department of Transportation rules (which date back to at least 1919) say that.....

> ".....a container charged wtih compressed gas must not be shipped unless...charged by or with the consent of the owner." (49 CFR 173.301[b])

Similary, the U.S. Department of Labor's OSHA regulations include the stipulation that.....

> "...containers shall be filled or used only upon authorization of the owner." (29 CFR 1910.110[b][14][ii])

Is it in the public interest to enact a container law?

The concern and need for a state law relates to the larger cylinders and tanks built according to specifications of the U.S. Department of Transportation (DOT) and the American Society of Mechanical Engineers (ASME). DOT cyclinders and ASME tanks are commonly used at residential and commercial locations for space heating, cooking, and water heating. These containers are not usually owned by consumers, though they can be. Most often, the LP-gas marketer retains ownership in order to oversee the safe operation of the entire fuel system, since consumers and business owners can't be expected to inspect and maintain their containers properly. The LP-gas supplier who retains ownership of the container can also monitor its condition and use throughout its service life. This affords an extra level of safety and assurance for the consumer.

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HB 165

STATE CONTAINER LAWS *

ARKANSAS Senate Bill No. 413 of 1957, located in Section 53-174 throug 53-727 of state code.

CALIFORNIA Section 13480, Section 14427 and Section 13560 of the Business and Professions Code.

COLORADO Co. Rev. Statutes 8-20-302; Current edition of NFPA #58 is used.

DELEWARE Title 16, Chapter 72; NFPA #58 & #54.

FLORIDA Statute prohibits filling of containers identified by the Division as being in violation of the law or regulations or by other than the owner or authorizied individual; NFPA #58 & #54 adopted.

GEORGIA LP Safety Act of GA Title 10, Act No. 558 amending Chapter 73-2 (1979); NFPA #58 & 54.

HAWAII Chapter 132, State Fire Marshall, Section 708-838.

IDAHO Title 39, Chapter 22, Section 39-2203; NFPA #58.

ILLINOIS Chapter 96 1/2, Section 5601 to 5604 of the Illinois Revised Statutes; NFPA #58 & #54.

INDIANA Title 22, Section 11-5-1, Chapter 15; NFPA #58 & #54.

KANSAS Chapter 55, Oil & Gas, Article 11, LPGas, Section 55-1101 through 55-1105; NFPA #58.

KENTUCKY Title 29, Chapter 234, Sections 234.110-234.200; NFPA #58.

LOUISIANA Title 40, Chapter 10, Section 1106 of Louisiana Statutes; Act 214, Laws 1984 allows the Board to adopt NFPA #58.

MARYLAND Annotated Code of MD, Chapter 38A, Section 11-601-through 11-606; NFPA #58 & #54.

MASSACHUSETTS 527 CMR 6.05 (4); NFPA #58, except for chapter 6.

MICHIGAN Chapter 29, Section 429.11 of the Michigan Compiles Laws Annotated; NFPA #58.

MINNESOTA Section 299F.40 of the MN Statutes Annotated; NFPA #58.

MISSOURI Section 323.030 of the Missouri Revised Statutes.

NEVADA Section 590:535; NFPA #58 & #54.

NEW JERSEY Section 21:1B of NJSA; NFPA #54, #58, & #59.

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NORTH CAROLINA Section 119-58(b); NFPA #58 & #54.

OKLAHOMA Section 420.9 of OK Statutes; NFPA #58 & #54.

PENNSYLVANIA Title 35, Chapter 14A, Section 1322; NFPA #54 & #58.

SOUTH DAKOTA Section 34-39-9; NFPA #58 & #54.

TENNESSEE Section 68-26-108; NFPA #58 & #54.

VIRGINIA Title 18.2; NFPA #58 & #54.

WISCONSIN Section 101.16(3). NFPA #58 & #54.

ALABAMA Adopted NFPA #58; No container law.
ALASKA NFPA Codes apply; No conainer law.
ARIZONA Adopted NFPA #58; No container law.
CONNECTICUT Adopted NFPA #58 & #54; No container law
DISTRICT OF COLUMBIA No container law.
IOWA NFPA #58 & #54; No container law.
MAINE NFPA #58 & #54; No container law.
MISSISSIPPI NFPA #58 & #54; No container law.
MONTANA Uniform Building Code and Uniform Fire Code; No container law.
NEBRASKA No specific cite for law, lists temperature correction, meter provisions, sales tickets and general info.; Statutory Authority: Chapter 81, State Adminstrative Agencies, Article 5, State Fire Marshal; Chapter 57, Minerals, Oil, Gas, ARticle 5, LP Gas of the Revised Statutes of Nebraska, 1943; NFPA #58 & #54 adopted.
NEW HAMPSHIRE NFPA #58 & #54; No container law.
NEW MEXICO NFPA #58 & #54; No container law indicated.
NEW YORK NFPA #59; No container law.
NORTH DAKOTA NFPA #58 & #54; No container law.
OHIO NFPA #58, #54, & #69; No container law.
OREGON NFPA #58, #54, & #59; No container law.
RHODE ISLAND Underwriters Laboratories; NFPA #58 & #59; No container law.
SOUTH CAROLINA No cite. The regulations state that every container of 100 lbs. or greater must have a tag, label or marking which plainly shows the name of the person or firm supplying LP-Gas to the system. It is unlawful to fill the system with LP-gas without the consent of the listed supplier; however, if the consumer requests another supplier to fill the system, the new supplier is obligated to contact the old supplier within 24 hours of connecting the new service. A copy of the notice to the old supplier must also be filed with the LP-Gas Division of the South Carolina Insurance Division.
TEXAS NFPA #58; No container law.
UTAH National Fire Code and local regulations.
WASHINGTON NFPA #58; No container law.
WEST VIRGINIA NFPA #58 & #54; No container law.
WYOMING NFPA #58 and Uniform Fire & Bldg. Codes; No container law.

* Source: LP-Gas Laws and Regulations, 1986.

3/29/91

EXHIBIT 2
DATE 1-21-93
HB 182

HOUSE BILL 182

House Business and Economic Development Committee

January 21, 1993

Testimony of:
Robert C. Pyfer
Vice President, Government Relations
Montana Credit Unions League

Mr. Chairman, members of the committee, for the record, I'm Bob Pyfer, Vice President-Government Relations, for the Montana Credit Unions League. The League represents 90 of Montana's 94 natural person credit unions. Credit unions are not-for-profit, nonstock, consumer financial cooperatives. A credit union is owned and controlled by its user-members through a one-member, one-vote process, whereby the board of directors is elected. All board and committee members are uncompensated volunteers.

This bill relates to a special kind of credit union--what is called "a corporate credit union." A corporate credit union is a credit union's credit union. Other credit unions become members of the corporate. The member credit unions may borrow from the corporate, if necessary, and invest excess funds with their corporate credit union. The corporate may also provide its members other financial services such as correspondent check collection and automated funds transfer services.

My testimony today will consist of three parts. The first part will give the purpose of the legislation; the second part will describe the methodology behind the bill as drafted; and the third part will involve a brief section by section analysis.

I. PURPOSE

The purpose of this bill is to respond to a federal mandate. NCUA, or the National Credit Union Administration, is the chief regulator for federally chartered credit unions. NCUA also administers the National Credit Union Share Insurance Fund, or NCUSIF, which insures both federally chartered credit unions and state chartered credit unions. NCUA has adopted an extensive new regulation applicable to federally chartered corporate credit unions. It has also made the regulation applicable to state chartered corporates by prohibiting federally insured credit unions from investing in a corporate that is not in compliance. Since all credit unions in Montana, state and federal charters, are federally insured through NCUSIF, any corporate in Montana would have to comply, whether that corporate were state or federally chartered.

In fact, we have just one corporate credit union in Montana--that is Treasure State Corporate Central Credit Union, which is located here in Helena. Treasure State Corporate is a state chartered credit union and therefore subject to the state laws on corporate credit unions which this bill amends. The bill amends our state laws to bring them into conformance with the new federal regulation and thereby to bring Treasure State into conformance with the new regulation.

Without these amendments, Treasure State would be forced to convert to a federal charter. We don't want this to happen because we want Treasure State Corporate to stay a state chartered credit union, thereby supporting our dual chartering system for

financial institutions here in Montana. A dual chartering system allows for a choice between state and federal charters and has many benefits. In general, a state regulator is closer to home, more accessible, and more knowledgeable about the special problems indigenous to our local state economy.

II. METHODOLOGY

As mentioned earlier, this bill is necessary to conform to a federal regulation. It would be easiest to simply incorporate the federal regulation by reference simply stating that Montana state chartered corporates "shall comply with Title 12, Part 704, of the Code of Federal Regulations in all respects." However, we have Montana Supreme Court cases that would declare such an incorporation by reference an unconstitutional delegation of legislative authority to the federal government. On the other hand, to repeat verbatim all of the federal regulation in our state statutes would be overly wordy, cumbersome, and inflexible. It would be impossible to change our state law on a timely basis whenever the federal regulation changed.

The approach we have chosen, therefore, is something of a hybrid. We do repeat nearly verbatim some parts of the federal regulation in the bill where this is essential to understanding and to give sufficient detail to avoid the constitutional problem. We then give rulemaking authority to the Department of Commerce which regulates state chartered credit unions. The Department would fill in the gaps by adopting rules that

conform to the federal regulation. As the federal regulation changes, the Department could revise its rules on an ongoing basis. In this way, we avoid the constitutional problem but still provide adequate flexibility.

III. SECTION BY SECTION ANALYSIS

Section 1. Amends 32-3-801, MCA. Organization.

The only change here is in the name. "Central Credit Union" is changed to "Corporate Credit Union." This merely comports with the nomenclature used in the federal regulation and recognizes the corporate as a credit union serving other corporate entities.

Section 2. Amends 32-3-802, MCA. Purpose--Membership.

New subsection (1) makes it clear that the primary purpose of a corporate credit union is to serve other credit unions. New subsection (4) specifically limits natural person members to seven, which is the number required to incorporate a new credit union under our Montana state act. The federal regulation requires reference to the number of persons necessary to incorporate under state law. Other revisions basically delete various types of natural person members.

In a credit union, every member has one vote in the election of directors and committee members. NCUA's concern here is that too many natural person members could control a credit union to the potential detriment of the corporate members, i.e., the credit unions, which the corporate is primarily created to serve.

Section 3. Amends 32-3-803, MCA. Conflict of Interest.

Subsection (2) (a) incorporates the basic rule against conflicts of interest involving the personal pecuniary interests of an official or an employee.

Subsection (2) (b) incorporates the basic rule against conflicts of interest involving another organization in which an official or an employee has an interest. The interested person may not participate if the matter is "material." Material is defined by Department rule under this subsection. The rule would follow the federal regulation which currently says material means 5% of capital. If the federal regulation changes, the Department of Commerce would respond with a conforming rule change.

Subsection (3) provides for express rule making authority to the Department of Commerce in conformance with the federal regulation.

Section 4. Amends 32-3-804, MCA. Additional Rights and Powers.

In subsection (2), the bill deletes current language allowing the purchase (or acceptance of a "merger") of a liquidated natural person credit union. This again merely comports with the concept of a corporate credit union as a credit union's credit union. All other changes in this section merely tie corporate activities to governance by Department rule. Activities listed include loans, correspondent services and other financial services, borrowing, investments, strategic planning, funds management, capital goals, and services in general. Department rules must conform with the federal regulation.

Section 5. New. Membership Capital Share Deposits.

Myrt White, chief operating officer of Treasure State Corporate Central Credit Union, will give more details on membership capital share deposits (MCSD) in her testimony.

In essence, this section would allow the corporate to issue at-risk shares subordinated to all other liabilities in order to increase the corporate's capital base. The section is nearly verbatim from the federal regulation definition. The intent is to describe attributes of a true capital investment.

Section 6. New. Fixed Assets.

This section limits the amount that a corporate can have tied up in fixed assets, such as real estate, to 15% of capital. This recognizes the liquidity risks of fixed asset

investments. It also recognizes the primary purpose of a corporate to serve its member credit unions as opposed to making long-term investments in fixed assets. NCUA asked that this limitation be specified in state law. This is the reason that the 15% figure is stated rather than left to Department rule. If NCUA increases this amount and Treasure State wants to take advantage of the increase, we would have to wait until the next session of the Legislature.

Section 7. New. Reserves.

This section requires risk-based reserves; that is, it requires a minimum ratio or percentage of reserves to assets according to a schedule of types of assets and percentages. For example, coin and currency is considered a no-risk asset so 0% reserves are required in the schedule. At the other end of the spectrum, unsecured loans to credit unions must be calculated at 100% for reserving purposes. This schedule of types of assets and the percentages to be applied are listed in the federal regulation. This regulation is quite lengthy. The Department of Commerce would incorporate this schedule into its regulations and change it as NCUA changed their schedule.

Section 8. New. Annual Audit.

This section requires an annual CPA audit of the corporate and provides for distribution of the audit reports. This section is essentially verbatim from the federal regulations.

Section 9. New. Contracts.

This section relates to shared facilities, personnel, and equipment. Treasure State Corporate currently purchases services and rents facilities from the Montana Credit Unions League at our offices on Helena Avenue. This section requires a written contract supporting and documenting the arrangement. We currently have a written agreement. Again, this section is essentially verbatim from the federal regulation.

Section 10. New. Codification.

This is the standard codification instruction placing the new bill sections into the corporate credit union part of the state credit union act.

Section 11. New. Effective Date.

This section provides for an immediate effective date in order to give Treasure State the earliest possible compliance with the federal regulation. Currently Treasure State is on temporary waiver from NCUA pending action by our Montana Legislature.

Mr. Chairman, members of the committee, this concludes my formal remarks on the bill. We'd be happy to answer any questions from the committee. We urge a "do pass" recommendation from the committee. Thank you.

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:11-5-92 : 11:33 : ADMIN - 7th Floor-

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

EXHIBIT 2a.
DATE 1-21-93
HB 182

November 4, 1992

Mr. Robert C. Pyfer
Vice President, Government Relations
Montana Credit Union Network
1236 Helena Avenue
Helena, MT 59601

Dear Mr. Pyfer:

As you requested, we have reviewed your proposed legislation regarding corporate credit unions.

It appears that the material requirements of Part 704 have been addressed in your legislation. Additional language should be considered addressing Part 704 requirements for strategic plans, policies addressing funds management, capital goals, and services. Requirements should be set forth requiring an annual opinion audit and that services, facilities, personnel, or equipment shared with any party be supported by a written contract. Also, consideration should be given to limiting the corporate credit union's investment in fixed assets in the legislation.

If you have any questions or comments, please contact us.

Sincerely,

D. Michael Riley
Director
Office of Examination and Insurance

EI/KAI:ki

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

January 8, 1993

EXHIBIT 2a
DATE 1/21/93
HB 182

Mr. Robert C. Pyfer
Vice President, Government Relations
Montana Credit Union Network
1236 Helena Avenue
Helena, MT 59601

Dear Mr. Pyfer:

We have reviewed your second draft bill for revision to the Montana laws governing corporate centrals. It appears that the concerns raised in our letter of November 4 were addressed in this second draft. We have no additional comments or recommendations.

Thank you for the opportunity to comment.

Sincerely,

D. Michael Riley
Director
Office of Examination and Insurance

EI/KAI:ki

cc: Region VI Director
CE Doug Ito
Ron Alf

Part 704

EXHIBIT 2b
DATE 1-21-93
HB 182

Corporate Credit Unions

§704.1 Scope.

(a) This Part establishes special rules for all federally insured corporate credit unions and grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this Part, other provisions of NCUA's Rules and Regulations (12 CFR Part 700 *et. seq.*) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The NCUAB has the authority to issue orders which vary from this Part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a).

§704.2 Definitions.

"Affiliated organization" means (1) an organization with which the corporate credit union shares facilities, personnel, equipment, or services; or (2) an organization which is at least 20 percent owned or controlled by an organization with which the corporate credit union shares services, facilities, personnel, or equipment.

"Asset-backed securities" (ABS) means all securities supported by installment loans or leases or by revolving lines of credit. This definition excludes those securities referred to in the financial markets as mortgage-backed securities (MBS) which includes collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs).

"Average daily assets" means the daily average of net assets calculated on the basis of assets at the close of each day in the period.

"Average life" means the weighted average time to principal repayment with the amount of the principal paydowns (both scheduled and unscheduled) as the weights.

"Capital" means the total of all corporate reserves (regular or statutory reserves, as applicable), all undivided earnings, net income, and membership capital share deposit (or equivalent) accounts.

"Capital of a broker/dealer" means the sum of stockholder equity plus subordinated debt which qualifies as capital for regulatory purposes.

"Claims" means loans or other debt obligations.

"Commitments" means any unconditional arrangement that obligates a corporate credit union to extend credit in the form of loans or lease financing receivables; to purchase loans, securities or other assets; or to participate in loans and leases. Commitments also include overdraft facilities, revolving credit, home equity, and mortgage lines of credit, and similar transactions. An obligation is conditional if the corporate credit union is not automatically obligated to extend funds.

"Corporate credit union" means a credit union that: (1) is operated primarily for the purpose of serving other credit unions; (2) is designated by the National Credit Union Administration as a corporate credit union; and (3) limits natural person members to the minimum required by state or federal law to charter and operate the credit union.

"Corporate reserves" means regular or statutory reserves, as applicable, excluding all valuation allowances established to meet the full and fair disclosure requirements of Section 702.3 of this Chapter.

"Credit equivalent amounts" means the face amount of each off-balance sheet item multiplied by a credit conversion factor outlined in Appendix B.

"Credit union service organization" (CUSO) means an organization that: (1) exists primarily to meet the needs of credit unions; and (2) engages only in business activities relating to the daily operations of the credit unions it serves or provides services associated with the routine operations of credit unions.

"Expected maturity" means the date on which all remaining principal amounts of an instrument or bond are anticipated to be paid off on the basis of projected payment assumptions.

"Federally issued CMO/REMIC" means a CMO or REMIC which is issued by a U.S. Government agency or a U.S. Government-sponsored corporation or enterprise.

"Foreign bank" means an institution which is organized under the laws of a country other than the United States, which is engaged in the business of banking, and which is recognized as a bank by the banking supervisory authority of the country in which it is organized.

"Material" means an amount that exceeds 5 percent of the corporate credit union's capital.

"Membership capital share deposit" (MCSD) account means a share, or deposit, or other account that: (1) is established, at a minimum, as a 12-month notice account; (2) is limited to members; (3) is not subject to share insurance coverage by the National Credit Union Share Insurance Fund (NCUSIF) or other deposit insurers; and (4) in the event of liquidation of the corporate credit union, is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured obligations to shareholders and the NCUSIF. In any event, an MCSD account shall not be repayable until notice that the accountholder credit union intends to withdraw MCSD account funds from the corporate credit union, except in the case of a credit union that is placed into liquidation, is purchased and assumed, or is merged. MCSD accounts cannot be used to pledge borrowings. Corporate credit unions that issue MCSD accounts shall disclose, at least annually to their members, the terms and conditions under which such accounts are issued.

"Member reverse repurchase transaction" means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

"Net assets" means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions.

"Non credit union member" means any member of a corporate credit union that is not chartered or licensed as a credit union.

"Original maturity" means the length of time between the date when a commitment is issued and the earliest date on which the corporate credit union can unconditionally cancel the commitment.

"Other reserves" means reserves other than corporate reserves.

"Primary capital" means all corporate reserves and undivided earnings.

"Privately issued CMO/REMIC" means a CMO or REMIC that qualifies as a permissible investment for a federal credit union pursuant to the provisions of Section 107(15) (B) of the Federal Credit Union Act.

"Risk-based capital" means the total of primary capital and secondary capital (up to 100 percent of primary capital).

"Risk-weighted assets" means the sum of total balance sheet assets and off-balance sheet credit equivalent amounts multiplied by their appropriate risk weights.

"SEC-recognized rating agency" means any firm recognized by the Securities and Exchange Commission (SEC) as qualified to assign risk ratings to various instruments required to be registered with the SEC.

"Secondary capital" means MCSD or equivalent accounts (except for MCSD accounts owned by other corporates unless the MCSD account is held by a corporate whose members are primarily other corporates and organizations recognized under Section 501(c) (6) of the Internal Revenue Code), allowance for loan and lease losses up to a maximum of 1.25 percent of risk-weighted assets, and term subordinated debt weighted by remaining maturity as indicated:

1. 5 years or more until maturity—100 percent;
2. 4 to less than 5 years until maturity—80 percent;
3. 3 to less than 4 years until maturity—60 percent;
4. 2 to less than 3 years until maturity—40 percent;
5. 1 to less than 2 years until maturity—20 percent; and

6. Less than 1 year remaining maturity—0 percent.

MCSD accounts upon which the accountholder has given the corporate credit union notice of intent to withdraw may no longer be considered secondary capital.

"Speculative activities" means the use of forwards, options, futures, or similar activities other than when used to reduce interest rate risk.

"Term subordinated debt" means debt of a corporate credit union that: (1) is unsecured; (2) is not a deposit; (3) is not insured by the National Credit Union Administration; (4) is subordinated to general creditors and claims of depositors; (5) has an original maturity of at least 7 years; (6) is not redeemable prior to maturity except with the approval of NCUA; (7) is ineligible as collateral for a loan; and (8) is represented by a debt instrument which clearly states that it will absorb losses.

"Undivided earnings" means all forms of retained earnings, except: (1) corporate reserves (regular or statutory reserves, as applicable); and (2) valuation allowances established to meet the full and fair disclosure requirements of Section 702.3 of this Chapter.

"United States depository institutions" means offices or branches (foreign and domestic) of federally insured banks and depository institutions chartered and headquartered in the United States, Puerto Rico, and U.S. territories and possessions. This includes banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, international banking facilities of domestic depository institutions, and U.S. chartered depository institutions owned by entities outside of the United States.

"United States Government or its agencies" means the United States Government or instrumentalities of the United States whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States Government (see Appendix C).

"United States Government-sponsored corporations and enterprises" means agencies originally established or chartered to serve public purposes specified by Congress, but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government (see Appendix C).

§704.3 Planning: Strategic and Business Plans.

(a) The board of directors of a corporate credit union shall adopt a strategic plan with appropriate objectives and goals. This plan will be reviewed periodically during the year to determine that the goals are being accomplished. At least annually, the strategic plan will be reviewed and updated.

(b) A business plan will be prepared for any material expenditure in fixed assets, new products and services, or investments in a CUSO.

§704.4 Asset/Liability Management.

(a) *General.* Corporate credit unions shall develop and implement comprehensive written funds management policies.

(b) *Monitoring.* Corporate credit unions shall prepare monthly reports showing the degree of mismatch between the sources and uses of funds for the various timeframes.

§704.5 Capital Goals, Objectives and Strategies.

(a) *General.* Corporate credit unions shall adopt formal, written goals (both long-term and short-term), objectives and strategies, including a budgetary process, for the building of capital.

(b) *Impact study.* Where a proposed new service or program, purchase or lease of a fixed asset, or investment in or loan to a CUSO has a material effect on a corporate credit union, the corporate credit union shall perform a cost/benefit analysis of the activity and a study of its impact on the capital position of the corporate credit union.

(c) *Monitoring.* Management will establish monitoring standards and procedures to periodically review and reassess the capital position of the corporate credit union and will document the review.

§704.6 Investment.

(a) *Policies.* A corporate credit union shall develop written investment policies which address, at a minimum:

(1) Risk diversification;

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(2) Funds management strategies;

(3) Approved investment issuers, instruments, credit limits, credit ratings, and list of permissible institutions;

(4) Approved list of broker/dealers;

(5) Authorization of and limitations on persons/committees making investments; and

(6) Procedures to periodically evaluate the quality of the investment portfolio.

(b) *Limitations.*

(1) Credit Union Service Organizations (CUSOs). The aggregate of all investments in CUSOs shall not exceed 15 percent of a corporate credit union's capital unless permission is obtained from the National Credit Union Administration Board (NCUAB). A corporate credit union is prohibited from utilizing CUSO authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks or obligations of another financial institution, insurance company, trade association, liquidity facility, or similar organization. Except to the extent that they are inconsistent with this paragraph, a corporate credit union investing in a CUSO shall adhere to the applicable provisions of paragraphs (c)-(e) of Section 701.27 of this Chapter.

(2) Other Investments. Corporate credit unions shall be limited to the following additional investments:

(i) Investments authorized by Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act and Part 703 of this Chapter, except where those authorities are inconsistent with other limitations of this section;

(ii) Deposits in state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(iii) Deposits in, the sale of Federal Funds to, and debt obligations of foreign banks subject to the following requirements: (A) the bank must have assets of at least US$ 20 billion, and the investment must be rated not lower than A-1 (or equivalent) for short-term (initial maturity of 1 year or less) investments by an SEC-recognized rating agency, and not lower than AA- (or equivalent) for long-term (initial maturity over 1 year) investments. Short-term investments downgraded below A-2 (or equivalent) and long-term investments downgraded below A- (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested; (B) the investment shall be denominated in United States dollars; (C) the country in which the issuing bank is organized shall be rated AAA (or equivalent) for political and economic stability by an SEC recognized rating agency; and (D) aggregate investments in any single foreign bank are limited to not more than 5 percent of the corporate credit union's net assets;

(iv) Debt obligations of U.S. bank holding companies and other U.S. chartered corporations rated not lower than A-1 (or equivalent) for short-term investments (initial maturity of 1 year or less) by an SEC-recognized rating agency and not lower than AA- (or equivalent) for long-term investments (initial maturity over 1 year). Short-term investments downgraded below A-2 (or equivalent) and long-term investments downgraded below A- (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested. The total investment in the obligations of any single issuer shall not exceed 5 percent of the corporate credit union's net assets. This authority does not apply to debt obligations that are convertible into the stock of the corporation or holding company;

(v) Asset-backed securities subject to the following requirements: (1) rated not lower than AAA (or equivalent) by an SEC-recognized rating agency; (2) limited to a maximum of 5 percent of the corporate credit union's net assets for any single security or trust; and (3) having an average life at the time of purchase not to exceed 5 years. Asset-backed securities downgraded below AA- (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested;

(vi) Federally issued CMOs/REMICs and privately issued CMOs/REMICs as defined in Section 3(a) (41) of the Securities Exchange Act of 1934. CMOs and REMICs are limited further as follows:

(A) *Fixed rate.* An investment in a fixed-rate CMO/REMIC must have an expected average life not to exceed 5 years given an immediate and

sustained increase of 300 basis points in mortgage loan commitment rates. This average life standard shall apply at the time of purchase and on any subsequent review date assuming market interest rates and prepayment speeds at the time that the test is applied. A corporate credit union shall use the average of the prepayment estimates of several major securities dealers as the prepayment assumption for the underlying mortgages. In computing the expected average life of a CMO/REMIC investment, it must be assumed that the anticipated rate of prepayment remains constant over the remaining life of the mortgage collateral. This limitation does not apply if principal payments of the investment are specifically matched to principal payments of the corresponding liability.

(B) *Variable rate.* If the CMO/REMIC has a variable interest rate with a cap, then the lesser of the highest interest rate cap or the final interest rate cap during the average life at the time of purchase must be at least 200 basis points above the rate of the corresponding liability that it is matched against. This limitation does not apply if principal payments of the investment are specifically matched to principal payments of the corresponding liability.

(C) *Divestiture.* Any CMO/REMIC security downgraded below AA- (or equivalent) by the same SEC-recognized rating agency used when the investment was purchased, if material in amount, shall be divested.

(D) *Issuer Limitation.* Privately issued CMO/REMIC securities shall not exceed 5 percent of the corporate credit union's net assets for any single issuer.

(vii) Additional investments provided the corporate credit union has obtained permission from the NCUAB.

(c) *Exclusion.* The requirements of this section to divest investments downgraded below the minimum acceptable ratings do not apply if the expected maturity for the downgraded investment is 3 months or less.

(d) *Divestiture Time Frame.* The corporate credit union has 10 business days to divest itself of any investment that does not comply with the requirements of this section or to request permission from the NCUAB to hold the investment. Any investment acquired before the effective date of this regulation is not subject to this divestiture requirement.

§704.7 Lending.

(a) *Policies.* A corporate credit union shall develop written loan policies which address, at a minimum:

(1) Loan types and limits;
(2) Documentation for each loan and line of credit;
(3) Security;
(4) Analysis of financial and operational data;
(5) Monitoring standards; and
(6) Review and reassessment of the credit quality of the borrower.

(b) *General.* Each individual loan or line of credit limit will be determined after analyzing the financial and operational soundness of the applicant and the ability of the applicant to repay the loan. Loans are limited as follows:

(1) *Loans to member credit unions.* The maximum aggregate amount in loans and approved lines of credit to any one member that is a credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF and member reverse repurchase transactions, shall not exceed the corporate credit union's capital or 10 percent of the corporate credit union's shares and capital, whichever is greater;

(2) *Loans to members that are not credit unions.* The aggregate amount of loans and lines of credit to credit union service organizations (CUSOs) and to members other than credit unions shall not exceed 15 percent of the corporate credit union's capital unless permission is obtained from the NCUAB.

(3) *Loans to credit unions that are not members of the corporate credit union.* The aggregate amount of loans to other credit unions that are not members of the corporate credit union shall not exceed 25 percent of the corporate credit union's shares and capital. The maximum aggregate amount in loans and approved lines of credit to any one borrower, excluding pass-through and guaranteed loans from the CLF and the NCUSIF and member reverse repurchase transactions, shall not exceed the corporate credit union's capital

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or 10 percent of the corporate credit union's shares and capital, whichever is greater. Loans resulting from a loan participation purchased from another corporate credit union are excluded from this 25 percent limitation.

(c) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union and must retain an interest of at least 5 percent of the face amount of the loan. The participation agreement may be executed at any time prior to, during, or after disbursement.

(d) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans made at fixed and variable rates to member credit unions or other organizations.

§704.8 Borrowing.

A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. Additional borrowing authority can be obtained from the NCUAB.

§704.9 Services.

A corporate credit union may provide services to its members involving investments, liquidity management, payment systems, and correspondent services, unless otherwise prohibited by the NCUAB, or, in the case of a state-chartered corporate credit union, prohibited by state law. The corporate credit union will maintain written agreements with vendors and other providers of services.

§704.10 Fixed Assets.

(a) *General.* A corporate credit union's ownership in fixed assets shall be limited as described in Section 701.36 of this Chapter, except that in lieu of paragraphs (c)(1)-(4) of Section 701.36, paragraph (b) of this section applies.

(b) *Investment in Fixed Assets.*

(1) No corporate credit union, without the prior written approval of the NCUAB, shall invest in fixed assets where the aggregate of all such investments exceeds 15 percent of capital.

(2) A corporate credit union shall submit requests to exceed the limitation of paragraph (b) (1) of this section to the Director, Office of Examination and Insurance. Requests shall be supplemented by such statements and reports as the Director, Office of Examination and Insurance, may require. If the corporate credit union does not receive notification of the action taken on its request within 45 calendar days of the date the request was received by the Director, Office of Examination and Insurance, the corporate credit union may proceed with its proposed investment in fixed assets. If the NCUAB determines that the proposal will not adversely affect the corporate credit union, it will respond in writing and an aggregate dollar amount or percentage of total capital will be approved for investment in fixed assets.

§704.11 Corporate Reserves.

(a) *Minimum Capital Ratio.* Each corporate credit union shall maintain a minimum ratio of risk-based capital to risk-weighted assets as follows:

(1) Within 90 days of the effective date of this regulation, primary capital shall be at least 4 percent of risk-weighted assets, or the corporate credit union will develop and implement a plan acceptable to NCUA for achieving an adequate level of primary capital consistent with the provisions of this regulation. This plan shall be submitted to the Director, Office of Examination and Insurance.

(2) By January 1, 1994, total capital shall equal at least 8 percent of risk-weighted assets, or the corporate credit union will develop and implement a plan acceptable to NCUA for achieving an adequate level of capital consistent with the provisions of this regulation. This plan shall be submitted to the Director, Office of Examination and Insurance.

(b) *Exceptions.* The NCUAB may modify a corporate credit union's reserve requirements under special circumstances.

(c) *Components of risk-based capital.* A corporate credit union's qualifying capital base

consists of primary and secondary capital of which at least 50 percent shall be composed of primary capital.

(d) *Limitations.* For purposes of calculating the amount of secondary capital, term subordinated debt shall not exceed 50 percent of secondary capital.

(e) *Procedures.* Balance sheet assets and credit equivalent amounts for off-balance sheet items are assigned to a risk-weight category. The total dollar amount in each category shall be multiplied by the risk-weight assigned to that category. The sum of the categories comprises risk-weighted assets.

(f) *Frequency.* Each corporate credit union shall calculate the ratio of capital to risk-weighted assets each month. A record of such calculation shall be maintained.

(g) *Risk Weights for Balance Sheet Assets.* Each balance sheet asset shall be assigned a risk weight of 0 percent, 20 percent, 50 percent, and 100 percent as indicated in Appendix A.

(h) *Other Considerations.* (1) An investment in the shares of a mutual fund is assigned to the risk category appropriate to the highest risk-weighted asset that the fund is permitted to hold. In addition, if the fund engages in speculative activities as defined in Section 704.2, then investments in the fund will be assigned to the 100 percent risk category.

(2) Accruals will be assigned the risk-weighting of the underlying asset that they represent.

(i) *Credit Conversion Factors for Off-Balance Sheet Items.* Off-balance sheet items will be risk-weighted each month using credit conversion factors as indicated in Appendix B.

(j) *Risk-Based Capital Ratios.* (1) The primary capital ratio is computed by dividing primary capital by total risk-weighted assets.

(2) The total capital ratio is computed by dividing risk-based capital by total risk-weighted assets.

(3) Month-end amounts will be used to calculate corporate credit union capital ratios.

(k) *Required Reserve Transfers.* The amount that a corporate credit union is required to transfer or set aside in corporate reserves is based on both the corporate credit union's primary and total capital ratios. Ranges of capital ratios have been established. These capital ratio ranges are then associated with 1 of 6 corresponding categories in determining the required reserve transfer. To qualify for a lower reserve transfer category, the capital ratios must fall in both the primary and total capital ratio ranges of the applicable category. The corporate credit union shall set aside an amount equal to the appropriate required reserve transfer percentage times the corporate credit union's average daily assets for the transfer period times the number of days in the transfer period divided by 365. Until January 1, 1994, transfers shall be based on the level of primary capital only.

(1) Category 1 requires a corporate reserve transfer percentage of at least 25 basis points of average daily assets when either the primary capital ratio is less than 4.0 percent or the total capital ratio is less than 8.0 percent. A corporate reserve transfer percentage greater than 25 basis points of average daily assets is required if needed to bring either or both of the capital ratios up to the minimum acceptable level, or the corporate credit union would have to obtain approval from the NCUAB to operate below the minimum capital levels.

(2) Category 2 requires a corporate reserve transfer percentage of 20 basis points of average daily assets when the primary capital ratio is greater than 4.0 percent and less than 6.0 percent or the total capital ratio is greater than 8.0 percent and less than 9.0 percent.

(3) Category 3 requires a corporate reserve transfer percentage of 15 basis points of average daily assets when either the primary capital ratio is greater than 6.0 percent and less than 8.0 percent or the total capital ratio is greater than 9.0 percent and less than 12.0 percent.

(4) Category 4 requires a corporate reserve transfer percentage of 10 basis points of average daily assets when either the primary capital ratio is greater than 8.0 percent and less than 10.0 percent or the total capital ratio is greater than 12.0 percent and less than 15.0 percent.

(5) Category 5 requires a corporate reserve transfer percentage of 5 basis points of average

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daily assets when either the primary capital ratio is greater than 10.0 percent and less than 12.0 percent or the total capital ratio percentage is greater than 15.0 percent and less than 18.0 percent.

(6) Category 6 requires a corporate reserve transfer percentage of 0 basis points when the primary capital ratio is greater than 12.0 percent and the total capital ratio percentage is greater than 18.0 percent.

(l) Corporate credit unions must provide reserves necessary for full and fair disclosure as specified in Section 702.3 of the NCUA Rules and Regulations.

§704.12 **Representation.**

(a) *Board Representation.* The board shall be determined as stipulated in the corporate credit union bylaws, provided that: (1) at least three directors are individuals who are not officers, directors, or employees of an affiliated organization; or (2) steps must be taken to assure open, independent elections including the following:

(i) The institution of a reasonable nomination by petition process; and

(ii) The use of mail balloting procedures (or equivalent procedures) in conducting elections to ensure that all members are provided an opportunity to participate in the election process.

(b) *Representatives of Organizational Members.* A member credit union or affiliated non-credit union member of a corporate credit union may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(c) *Recusal Provision.* (1) No director, committee member, officer, agent, or employee of a corporate credit union shall in any manner participate in the deliberation upon or the determination of any question affecting his/her personal pecuniary interest.

(2) No director, officer, agent, or employee shall in any manner participate in the determination of any matter material in amount (when measured annually as an aggregate of business arrangements with the corporation, partnership, or association) affecting the pecuniary interest of any corporation, partnership, or association (other than the corporate credit union) in which he/she has a direct or indirect interest, except if the matter involves the payment of dividends to the membership.

(3) In the event of the disqualification of any directors, by operation of paragraphs (1) or (2) of this provision, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) No committee member shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting the pecuniary interest of any corporation, partnership, or association (other than this corporate credit union) in which he/she is directly or indirectly interested. In the event of the disqualification of any committee member by operation of paragraph (1) or (4) of this subsection, the remaining qualified committee members, if constituting a quorum with the disqualified committee member, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(5) If any director, officer, agent, or employee participates in the determination of any matter which is not material in amount (when measured annually as an aggregate of business arrangements with the corporation, partnership, or association) affecting the pecuniary interest of any corporation, partnership, or association (other than the corporate credit union) in which he/she has a direct or indirect interest, that matter shall be documented in the minutes of the meeting and made available to any member upon request. Such approved matters shall also be disclosed to all members of the corporate credit union by appropriate means, such as the annual report of the corporate credit union. Disclosure to members shall include the names of all directors present

who acted on the matter and the nature of their interest, a description of the matter considered, the amounts involved, and evidence that the matter is fair and reasonable to the corporate credit union.

§704.13 Annual Audit.

(a) The supervisory committee of a corporate credit union shall cause an annual opinion audit to be made by an independent, duly licensed certified public accountant (CPA) and shall submit the audit report to the board of directors. A summary of the audit report shall be submitted to the membership at the next annual meeting;

(b) The CPA's audit workpapers shall be made available for review by the examiner during the examination; and

(c) A copy of the audit report and reportable conditions letter (i. e., management letter) shall be submitted to the Director, Office of Examination and Insurance, within 30 days after receipt by the board of directors.

§704.14 Contracts/Written Agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§704.15 State-Chartered Corporate Credit Unions.

This Part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

§704.16 Effective Date.

This regulation is effective beginning December 2, 1992 or June 29, 1992 if the corporate credit union plans to use the expanded authorities of paragraphs 6, 7, and 8 and has substantially complied with the other provisions of this Part. Any corporate credit union that is unable to comply with this regulation by the effective date shall obtain a temporary waiver from the Director, Office of Examination and Insurance. To obtain a waiver, the officials of the corporate credit union shall, at least 90 days before the effective date of this regulation, explain in writing the nature of and reasons for the noncompliance, state a target date by which the corporate credit union will be in compliance with the regulation, submit any and all information requested by the Director, Office of Examination and Insurance, necessary to make a decision concerning the waiver and request, in writing, that a waiver of this regulation be granted. The Director, Office of Examination and Insurance, will respond in writing within 45 days of receiving all requested information necessary to make a decision.

Appendix A

Summary of Risk Weights and Risk Categories for Corporate Credit Unions:

Category 1: Zero Percent Risk Weight.

a. Coin and currency on hand or physically in transit.

b. Balances due from and claims on Federal Reserve Banks.

c. Claims on and portions of claims that are unconditionally guaranteed by the U.S. Government or its agencies.

d. Claims collateralized by cash or eligible deposits.

e. CLF subscriptions, including U.S. Central CLF Participation Certificates, and CLF Pass-Through Loans from the CLF through U.S. Central to the corporate credit unions.

f. Asset Accounts related to Member Reverse Repurchase Agreements without indemnity obligation.

g. Claims on or unconditionally guaranteed by sovereign central governments of "AAA" rated countries.

h. Accrued interest receivable on the above.

Category 2: 20 Percent Risk Weight.

a. Items, other than coin and currency, in process of collection.

b. Claims on or portions of claims guaranteed by U.S. Government-sponsored corporations and enterprises.

c. Claims conditionally guaranteed by the U.S. Government or its agencies or U.S. Government-sponsored corporations and enterprises.

d. Claims or portions of claims (including Repurchase Agreements) collateralized by

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securities issued by the U.S. Government or its agencies or U.S. Government-sponsored corporations and enterprises.

e. General obligation claims on state and local governments located in the United States.

f. Claims on U.S. depository institutions (including Federal Funds sold) subject to the ratings requirements shown below.

g. Claims on depository institutions (including Federal Funds sold) chartered in countries rated AAA other than the United States subject to the ratings requirements shown below.

h. Claims on a corporate credit union.

i. Asset accounts related to Member Reverse Repurchase Agreements with indemnity obligations.

j. Delivery Versus Payment (DVP) Repurchase Transactions in which the corporate receives the securities collateralizing the transactions, and the corporate is authorized to invest in these securities.

k. Tri-party repurchase transactions with broker/dealers having at least $100 million in capital which are collateralized by securities that the corporate credit union is authorized to invest in.

l. Asset-backed securities rated no lower than AAA with remaining weighted average lives of 3 years or less.

m. All CMOs/REMICs (excluding CMOs/REMICs collateralized by whole loan mortgages) that comply with Section 6(b)(2)(vi).

n. Secured loans to credit unions.

o. Accrued Interest Receivable on above.

In order to have a 20 percent risk weighting, U.S. depository institutions and foreign banks must meet one of the following conditions:

(a) The institution has a short-term debt rating not lower than A-2 (or equivalent) by a SEC-recognized rating agency; or

(b) The institution has a long-term debt rating not lower than A- (or equivalent) by a SEC-recognized rating agency; or

(c) The institution has an issuer rating not lower than B/C (or equivalent) by a SEC-recognized rating agency.

Category 3: 50 Percent Risk Weight.

a. Asset-backed securities rated no lower than AAA with remaining weighted average lives greater than 3 years.

b. All CMOs/REMICs collateralized by whole-loan mortgages that qualify under Section 6(b)(2)(vi).

c. Accrued Interest Receivable on the above.

Category 4: 100 Percent Risk Weight for All Other Assets Including, but NOT LIMITED to:

a. Loans to and investments in CUSOs.

b. Unsecured loans to credit unions.

c. All fixed assets, including land, buildings, furniture, fixtures, equipment, automobiles, and leasehold improvements.

d. All Hold-in-Custody Repurchase Agreements.

e. Member Capital Share Deposits (MCSD) in a corporate credit union.

f. Stripped Mortgage-Backed Securities.

g. Residual Interests of CMOs/REMICs.

h. Zero Coupon Securities with a maturity date more than 5 years from the purchase settlement date of the security.

i. Claims on U.S. chartered corporations and bank holding companies, including commercial paper and corporate bonds.

j. Mutual Funds that do not qualify for a lower risk weighting.

k. Prepaid Assets.

l. Accounts Receivable and other receivables.

m. NCUSIF Deposit.

n. Mortgage servicing rights.

o. Intangible assets.

p. Accrued Interest Receivable on the above.

Appendix B

OFF-BALANCE SHEET CREDIT CONVERSION FACTORS

Zero Percent Credit Conversion Factor:

Unused portions of credit lines with original maturities of 6 months or less, or which are unconditionally cancellable.

50 Percent Credit Conversion Factor:

a. Unused portions of credit lines with original maturities exceeding 6 months.

b. Commitments to participate in a loan or loan package.

100 Percent Credit Conversion Factor:

a. Irrevocable standby letters of credit guaranteeing financial performance (including VISA letters of credit issued by corporate credit unions on behalf of their members, or standby letters of credit backing Industrial Revenue Bonds).

b. Forward Commitments to purchase an asset or perform under a lease contract.

c. Securities held in safekeeping loaned with indemnification. Other off-balance sheet items will be addressed on a case-by-case basis by the Director, Office of Examination and Insurance.

Appendix C

U.S. Government Obligations and U.S. Government Agencies.

a. U.S. Treasury Bills
b. U.S. Treasury Notes
c. U.S. Treasury Bonds
d. Commodity Credit Corporation
e. Export-Import Bank (Exim Bank)
f. Farm Credit System Financial Assistance Corporation (FCSFAC)
g. Farmers Home Administration (FmHA)
h. Federal Housing Administration (FHA)
i. General Services Administration (GSA)
j. Government National Mortgage Association (GNMA)
k. Maritime Administration (MA)
l. Overseas Private Investment Corporation (OPIC)
m. Small Business Administration (SBA)
n. Veterans Administration (VA)
o. Washington Metropolitan Area Transit Authority (WMATA)

U.S. Government-Sponsored Corporations and Enterprises.

a. Federal Home Loan Bank (FHLB)
b. Federal Home Loan Mortgage Corporation (FHLMC)
c. Federal National Mortgage Association (FNMA)
d. Resolution Trust Corporation (RTC)
e. Student Loan Marketing Association (SLMA)

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 704 and 741

Corporate Credit Unions and Requirements for Insurance

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: This rule expands the rights and responsibilities of federally insured corporate credit unions. The rule is necessitated by the expanded role of corporate credit unions in the credit union system. It should ensure that corporate credit unions remain safe and sound and will enable them to provide improved services to their member credit unions.

EFFECTIVE DATE: December 1, 1992.

ADDRESSES: Send comments to Becky Baker, Secretary of the NCUAB, National Credit Union Administration, 1776 G Street, NW., Washington, DC 20456.

FOR FURTHER INFORMATION CONTACT: D. Michael Riley, Director, or Ronald Alf, Corporate Credit Union Specialist, Office of Examination and Insurance (202) 682-9640, or Lisa Henderson, Staff Attorney, Office of General Counsel (202) 682-9630, at the above address.

SUPPLEMENTARY INFORMATION:

A. Background

On March 13, 1991, the National Credit Union Administration Board (NCUAB) issued a proposal to amend the regulations governing corporate credit unions and requirements for insurance (part 704 and § 741.9). See 56 FR 11952, March 21, 1991. In response to subsequent requests, the NCUAB extended the comment period to July 1, 1991. The NCUAB issued a revised proposal on November 13, 1991. See 56 FR 59224, Nov. 25, 1991. The comment period ended on January 9, 1992. The NCUAB, in response to comments and discussions with interested parties, has made a number of changes in this final regulation.

Although this is a final rule, the NCUAB is soliciting comments regarding technical changes that may be necessary. This is not a formal "comment period" within the meaning of 5 U.S.C. 553, but merely a vehicle for the NCUAB to be apprised of difficulties in implementing the regulation that may not have been foreseen by NCUA staff. The NCUAB stresses that the policy decisions have been made and are not, at this time, subject to modification. Therefore, comments should be confined to technical matters.

B. Comments

The comment period ended on January 9, 1992, for the November 13, 1991 proposal. Seventy-five comment letters were received: 27 from corporate credit unions, 9 from state leagues, 34 from natural person credit unions, 2 from national credit union trade associations, 2 from housing finance corporations, and 1 from a trade association representing broker/dealers. Nearly every provision in the regulation received at least one comment. The comments have been thoroughly considered by NCUA staff.

C. Section-by-Section Analysis

Section 704.1 Scope

Two commenters objected to extending part 704 to federally insured state chartered corporate credit unions, arguing that it would remove the advantage of the dual chartering system.

The NCUAB's position remains as stated in the November 13 proposal. Federally insured credit unions have a high percentage of their investments in corporate credit unions, including federally insured state-chartered corporate credit unions. Consistent standards for corporate credit unions with respect to operating framework, reserving, and asset/liability management are essential to maintaining a viable system. Accordingly, this regulation applies to both federal corporate credit unions and federally insured state-chartered corporate credit unions.

In this final rule, the NCUAB has added a provision clarifying its authority to issue orders which vary from the regulation. The authority to issue such orders is provided in section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). The added language clarifies that the NCUAB may, for example, permit corporate credit unions to provide services that are not explicitly listed in § 704.9 of this part.

Section 704.2 Definitions

Affiliated Organization

In response to comments, the NCUAB has added a definition for "affiliated organization". Such organizations would include leagues, league service corporations, credit union service organizations (CUSOs), joint venture companies, and any other organization with which the corporate credit union shares facilities, personnel, equipment, or services. The term also includes any organization controlled by or owned by any organization with which the corporate credit union shares facilities, personnel, equipment, or services.

Asset-backed Securities

At the suggestion of commenters, the definition was amended to clarify that the term does not include mortgage-backed securities.

Capital

The definition was changed to include net income.

Corporate Credit Union

In response to comments, the NCUAB notes that the requirement that a corporate credit union be designated as such by NCUA was included in the definition to prevent corporate credit unions from being formed without NCUA review. The NCUAB is aware that laws in some states will need to be changed in order to allow corporate credit unions to restrict their membership; therefore, the timing aspect of this requirement will be implemented in a flexible manner. However, while the November 13 proposal stated that existing natural person members could continue their memberships in the corporate credit union, this final rule requires corporate credit unions to terminate all natural person memberships above the minimum required by law to charter and operate a corporate credit union. Out of concern regarding the voting strength of natural person members, the NCUAB had proposed in § 704.12 to prohibit such members from voting on issues pertaining to the corporate credit union. In response to the objections of a number of commenters, the NCUAB has determined to allow natural person members to vote, but to restrict their numbers from the effective date of part 704. The corporate credit union's board of directors shall determine which natural person memberships to terminate.

Membership Capital Share Deposits (MCSD)

At the suggestion of a number of commenters, the NCUAB has dropped the requirement that a credit union's membership be terminated for 1 year after withdrawing funds from its MCSD account. However, since permanence is an important element of capital, once a credit union gives notice to withdraw any portion of its MCSD account, that portion can no longer be considered secondary capital.

Despite the objections of 16 commenters, the NCUAB continues to believe that funds in MCSD accounts may not be used to collateralize borrowings by member credit unions from corporate credit unions. A specific pledge of an MCSD account against a

member credit union's loan balance reduces the level of capital to control the corporate credit union's overall risks and potential losses. If MCSD accounts are used to collateralize borrowings, their value as secondary capital is reduced. While funds in MCSD accounts may be used to offset a loss if the primary collateral is inadequate, corporate credit unions are expected to adequately collateralize loans to members: there should be little or no use of MCSD accounts to offset borrowings. The restriction on pledging applies to a credit union or a corporate credit union that is carrying the MCSD account as an asset.

In response to comments, the NCUAB has agreed to allow corporate credit unions to acquire MCSD accounts from other corporate credit unions; these funds, however, cannot be included as secondary capital for computing reserve transfers or for determining whether a corporate credit union is meeting its minimum capital requirements. These restrictions do not apply to U.S. Central Credit Union, which is a corporate credit union for corporate credit unions.

Although several commenters suggested changes to the language regarding creditor priority, the NCUAB believes that the proposed priority order is necessary to ensure that MCSD accounts function as capital and are available to fund losses to the corporate credit union.

In response to comments, the NCUAB has dropped the word "subordinated" from the first sentence of the definition of MCSD, since the other terms and conditions define the nature of the account. A phase-in period of approximately 18 months has been provided for corporate credit unions to establish MCSD accounts for the purposes of calculating total capital ratios.

Member Reverse Repurchase Transactions

At the suggestion of numerous commenters and in the interests of clarity, the definition of member reverse repurchase transactions has been reworded.

Secondary Capital

The definition has been amended so that the amount of term subordinated debt that counts as secondary capital declines as the debt approaches maturity.

Speculative Activities

In response to a request to provide a list of activities that are considered speculative, the NCUAB notes that it is not possible to provide such a list, as activities that could-be considered speculative in one scenario could reduce risk in a different scenario. The term "forwards" refers to such investment products as forward fed funds, forward contracts, forward agreements, etc. These instruments are considered speculative except when they are used solely to reduce interest rate risk.

Term Subordinated Debt

To be considered secondary capital, term subordinated debt must be "at risk". This "at risk" element is a critical factor in considering whether the account is the functional equivalent of capital. The ability of term subordinated debt to be used as capital to fund losses could be substantially reduced if the corporate credit union had the discretion to redeem such debt without NCUA's permission. Term subordinated debt does not have priority over the NCUSIF and MCSD accounts.

Section 704.3 Planning: Strategic and Business Plans

In response to continued objections to the requirement that corporate credit unions have strategic and business plans, the NCUAB wishes to emphasize again that such plans are vital to the success of a corporate credit union and are appropriately included in the regulation. The regulation establishes a broad framework for strategic and business plans; examiners will determine whether the corporate credit union has developed meaningful policies and procedures consistent with the requirements. In addition, NCUA will be developing a section of the Corporate Examiner's Guide on this issue.

Section 704.4 Asset/liability Management

In response to comments, the NCUAB wishes to clarify that a corporate credit union will be expected to develop asset/liability policies, procedures, and reports in relation to the degree of interest-rate risk and liquidity risk it undertakes. A corporate credit union with variable maturity instruments is expected to implement sophisticated procedures to control interest-rate risk and to provide reports to its board of directors regarding these controls. In general, a higher standard will be expected of a corporate credit union that elects to manage interest-rate risk than one which chooses to eliminate it through strict matching of the sources and uses of its funds.

Section 704.6 Investment

The NCUAB has declined to adopt a suggestion to drop the word "diversification" after "risk" in paragraph (a)(1). The word has been retained to emphasize the need for corporate credit unions to achieve adequate diversification of instruments and issuers. The expanded investment authority provided under this regulation should facilitate risk diversification of corporate credit union investment portfolios. The ability of corporate credit unions to apply individually for additional investment authority will also permit increased diversification. The degree of diversification is dependent on the amount of risk a corporate credit union has assumed and how well that risk is controlled.

In response to a request to permit corporate credit unions to invest in bank notes, the NCUAB notes that it has taken the position that section 107(8) of the FCU Act, 12 U.S.C. 1757(8), authorizes FCUs to purchase bank notes that constitute "deposits" for the purposes of the Federal Reserve Board's Regulation D (see 12 CFR part 204; see also NCUA Investment Report Number 7, dated February 1991). Thus, such investments are authorized under paragraph (b)(2)(i).

A number of commenters suggested changes to the proposed rating and divestiture requirements for asset-backed securities set forth in paragraph (b)(2)(v). Since asset-backed securities are relatively new investment instruments, the NCUAB believes they should be subject to higher rating standards than corporate and bank debt. However, because corporate and bank securities are not collateralized, the NCUAB has risk-weighted asset-backed securities with maturities of 3 years or less at 20 percent and corporate and bank debt at 100 percent.

At the suggestion of a commenter, and for diversification purposes, the term "issuer" in paragraph (b)(2)(v)(B) has been changed to "security or trust". To be considered a proper asset-backed security for the purposes of this paragraph, however, there should be a clear and legal separation of the business interests of the issuer from the trust.

A number of commenters argued that the CMO/REMIC average life test in paragraph (b)(2)(vi)(A) was too restrictive, particularly compared with the test set forth in part 703 for such investments for natural person credit unions. In light of the more stable liabilities of natural person credit unions, the NCUAB believes that it is appropriate for them to use a less restrictive average life test. The NCUAB also has clarified that industry consensus prepayment models must be used in computing the average life of a

prospective investment. Such models are the best mechanisms for providing consistent testing of average lives. Any models that utilize the average of the prepayment estimates of several major dealers for the mortgage collateral under review will satisfy this requirement. The NCUAB has also clarified that the average life test must apply at the time of purchase and on any subsequent review date. Also, the anticipated rate of prepayment must remain constant over the remaining life of the mortgage collateral. Finally, the NCUAB has deleted the provision exempting a CMO/REMIC from the limitations of the average life test if the security was purchased as an investment of reserves and undivided earnings. The NCUAB believes that reserves and undivided earnings should be used to offset all risks that credit unions may incur.

The NCUAB wishes to clarify that the "matching" referred to in paragraphs (b)(2)(vi) (A) and (B) refers to reducing a liability when principal payments are received on a corresponding investment, such that the balance of the liability mirrors the balance of the asset. This can also be done for multiple investments with matching liabilities. This practice effectively transfers the prepayment and extension risks to the member credit union.

In response to comments, the NCUAB has modified the divestiture requirement for downgraded CMOs/REMICs. Instead of requiring that any downgraded CMO/REMIC be divested, paragraph (b)(2)(vi)(C) now requires divestment only where the amount invested in such instruments exceeds 5 percent of capital.

Forty commenters objected to proposed paragraph (b)(2)(vi)(E)'s limitation of a corporate credit union's total investment in CMO/REMIC securities to 30 percent of its shares and capital.

Commenters suggested that the limitation could diminish the rate of return on investments in corporate credit unions, encouraging member credit unions to seek higher returns through riskier investments elsewhere. They also suggested that the limitation could result in corporate credit unions taking on more credit, prepayment, and extension risks. Commenters argued that while it is logical to control credit risk by establishing a limitation based on percentage of net assets, it is not logical to attempt to limit interest rate, extension, and prepayment risk using the same vehicle. It was suggested that these risks would be addressed by the new "shock test".

Persuaded by the commenters' concerns, the NCUAB has removed the 30 percent limitation. The NCUAB emphasizes, however, that a corporate credit union with significant concentrations of assets in variable maturity instruments such as CMOs/REMICs and asset-backed securities will be expected to have controls (such as portfolio modeling capabilities) to measure risk and to support its asset/liability strategy. The corporate credit union will be required to demonstrate that sufficient controls have been implemented to limit interest-rate risk under any possible scenario.

The NCUAB has modified paragraph (d), which addresses divestiture time frames. The proposed regulation required that investments be divested upon being downgraded below the minimum credit ratings allowable. The final regulation is broader, however, requiring divestiture of any investment that does not comply with the requirements of the regulation. The change recognizes that not all of the requirements in the regulation relate to credit ratings.

One commenter suggested, generally, that divestiture be required only when all SEC-recognized rating agencies have downgraded the investment. The NCUAB has declined to adopt this suggestion, believing that it would require a corporate credit union unnecessarily to subscribe to all rating agencies. Instead, divestiture will be required if a rating agency that was relied upon at the time of purchase lowers its rating below the minimum required in this regulation.

Section 704.7 Lending

In response to comments, paragraphs (b)(2) and (b)(3) have been combined, providing that the aggregate amount of loans to non credit union members and to CUSOs shall not exceed 15 percent of capital. In addition, loans resulting from loan participation agreements with other corporate credit unions have been excluded from the 25 percent limitation for loans to credit unions that are not members of the corporate credit union.

Section 704.8 Borrowing

Although a number of commenters objected to any restriction on credit union borrowing, the NCUAB believes that in light of the increased sources of liquidity for credit unions and their current excess liquidity, unlimited borrowing authority is not needed. However, the paragraph has been modified to provide that a corporate credit union can borrow up to 50 percent of its shares and capital or 10 times its capital, whichever is greater. CLF borrowings and member reverse repurchase agreements have been excluded from those limits. Corporate credit unions can be assured of timely action on requests to exceed the borrowing limits.

Section 704.9 Services

In response to comments, the NCUAB has removed the requirement that a corporate credit union have written agreements with users of its services. The NCUAB considers it sound business practice, however, for corporate credit unions to have contracts with users where there is a potential for liability, such as with wire transfers. Examiners will ensure that contracts are in place in such situations.

Section 704.10 Fixed Assets

Over the objections of a few commenters, the NCUAB continues to believe that the 15 percent limitation is appropriate for corporate credit unions. On the rare occasion that additional authority is necessary, the regulation provides a means for corporate credit unions to seek relief.

Section 704.11 Corporate Reserves

In response to comments, paragraph (a)(1) has been amended to require corporate credit unions to submit their capital plans to the Director, Office of Examination and Insurance, rather than to the regional director. The language "prior to payment of dividends" has been dropped from paragraph (f), since dividends on certain accounts are calculated and paid daily. However, the regulation still requires a monthly calculation of the ratio of capital to risk-weighted assets. At the suggestion of one commenter, corporate credit union assets and their accompanying weights are set forth in an appendix to the regulation, rather than in paragraph (g).

Two commenters stated that the proposed 0 percent risk-weight for balances due from a Federal Reserve Bank wrongly assumes that all checks are collected through the Federal Reserve System. They noted that many corporate credit unions have established local clearinghouse or direct presentment arrangements which bypass the Federal Reserve and recommended that this category be amended to include those arrangements. The NCUAB declines to modify this aspect of the risk-weight scheme, however, until it is demonstrated that the alternative arrangements are as risk-free as balances due from a Federal Reserve Bank.

Seventeen commenters recommended that corporate obligations, repurchase agreements, and loans to credit unions be risk-weighted at 20 percent. The NCUAB continues to believe that

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corporate obligations should be risk-weighted at 100 percent and notes that the other federal regulatory agencies risk-weight such obligations at 100 percent. The NCUAB agrees, however, that repurchase agreements and secured loans to credit unions should be risk-weighted at 20 percent and has modified the regulation accordingly. Corporate credit unions are reminded that repurchase agreements are permissible only if the collateral consists solely of securities that corporate credit unions are authorized to invest in. Any loan to a credit union that is only partially secured shall be 100 percent risk-weighted.

The NCUAB agrees with one commenter that the risk-weighting of asset-backed securities should be based on the remaining average life rather than average life at the time of purchase and has amended the regulation accordingly. Although the other regulatory agencies weight asset-backed securities at 100 percent, the NCUAB believes that in light of their AAA ratings and short average lives, these collateralized instruments present little risk of default and justify lower weights.

Several commenters questioned the need for required reserve transfer Category 1 under paragraph (k). The NCUAB believes that the 25 basis point reserve transfer requirement is needed until a corporate credit union can submit its reserve plan to the Director, Office of Examination and Insurance. The approved capital plan will address specific capital and growth issues of the corporate credit union.

The NCUAB agrees with two commenters that a transition period to implement the new reserving system is needed. Accordingly, while corporate credit unions will be expected to comply with the primary capital ratios on the effective date of this regulation, they will have until January 1, 1994, to comply with the total capital requirements. The NCUAB believes that these are reasonable timeframes for the transition from the previous reserving system. The NCUAB will work with corporate credit unions that have difficulty meeting the new minimum capital requirements.

Section 704.12 Representation

Thirty-seven commenters addressed this section. Eight supported paragraph (a), several stating that rather than just three directors, the majority should be independent. Twenty-seven commenters were opposed to some aspect of paragraph (a), generally arguing that it was undemocratic. Many of those commenters supported the concept of open, independent elections, but almost all were strongly opposed to excluding affiliated organizations from the nominating committee.

The NCUAB has carefully evaluated each of the comments concerning paragraph (a) and has determined not to restrict the appointment of the nominating committee beyond the procedures set forth in the corporate credit union's bylaws. It is expected, however, that the nominating committee will be appointed in such a manner as to represent the interests of the entire membership. Corporate credit unions should look to the NCUA publication, Federal Credit Union Bylaw Amendments and Guidelines (NCUA 8001A), for guidance regarding nominations by petition and mail balloting. The Director, Office of Examination and Insurance, and the regional directors will assist corporate credit unions in complying with the requirements of paragraph (a).

While five commenters supported the recusal provision set forth in paragraph (c), twenty-one were opposed to it. Most of the latter stated that it was inappropriate for any member of the board of directors or a committee to be disqualified, except for a direct conflict of interest where personal gain could be realized. A number stated that if a corporate credit union opts for a "fully democratic" election process, the recusal provision should not be applicable. Five commenters stated that the recusal provision was contrary to state law, the Model Business Corporation Act, and case law, where transactions between corporations having common directors are voidable only if they are actually unfair, not if they merely appear to be unfair. Another commenter objected to the inclusion of paid employees in the recusal provision and to the requirement that a disqualified director leave the room during all consideration of any pecuniary interest of any affiliated entity.

The NCUAB shares some of the concerns of the commenters and has extensively rewritten this paragraph. Matters involving personal pecuniary interest have been separated from matters involving the representation of member credit unions and affiliated organizations. In situations involving personal pecuniary interests, directors, officers, agents, and employees must recuse themselves. In situations involving pecuniary interests of corporations, partnerships, or associations in which directors, officers, agents, and employees have interests, those individuals must recuse themselves on material matters. If all directors have recused themselves, the matter must be voted upon by the membership. In situations not considered material, interested parties are not required to recuse themselves, but full disclosure must be made to the membership. The recusal provision is not intended to prevent employees from preparing and presenting information needed by the directors to render informed decisions.

In situations involving pecuniary interests of corporations, partnerships, or associations in which committee members have interests, those individuals must recuse themselves on all matters. If all committee members have recused themselves, the matter must be voted upon by the board of directors.

In response to comments, the NCUAB has deleted proposed paragraph (d), which prohibited natural person members from voting on issues pertaining to the corporate credit union. It has been long-standing NCUA policy that all members of a credit union be afforded the right to vote. Accordingly, natural person members of corporate credit unions shall retain this right. Since corporate credit unions must now terminate all natural person memberships above the minimum required by state or federal law to charter and operate a corporate credit union, the voting strength of natural person members' will be minimal.

Section 704.16 Effective Date

The NCUAB is implementing the effective dates that were proposed, believing that most corporate credit unions will be able to comply with the regulation within the prescribed timeframes. Corporate credit unions have until January 1, 1994, to comply with the minimum 8 percent total capital ratio requirement, which should be enough time to structure MCSD accounts. If there are problems in getting state laws amended, the NCUAB will consider reasonable waiver requests. After considering the suggestion of a commenter, the NCUAB has concluded that a corporate credit union need only be in substantial compliance with the regulation before being permitted to use the additional investment powers. The Director, Examination and Insurance, will determine whether a corporate credit union is in substantial compliance with the regulation.

Part 741—(Amended)

The language "and applicable state laws and regulations" was added to paragraphs (9)(a)(3) and (9)(b)(3) to clarify that state-chartered corporate credit unions cannot make investments

authorized in part 704, unless permitted by their state laws and regulations.

Miscellaneous

In response to suggestions, the NCUAB has determined that waiver requests should be processed through the Office of Examination and Insurance rather than the regional offices. The NCUAB's authority to determine whether or not a waiver should be granted may be delegated.

Regulatory Procedures

Regulatory Flexibility Act

The NCUA Board certifies that this final rule will not have a significant impact on a substantial number of small credit unions (those under $1 million in assets) because the rule applies only to federally insured corporate credit unions, which number 33 nationally. All corporate credit unions have assets well in excess of $1 million. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

This final rule contains a requirement for the collection of additional information and a maintenance of documentation by a federally insured corporate credit union. The regulation requires that each corporate credit union maintain a written strategic plan with goals and objectives to support the strategic plan, written policies, monthly monitoring reports, appropriate business plans and that federally insured state-chartered corporate credit unions obtain a CPA audit. Written investment and funds management policies, CPA audits and several monitoring reports are now required by the Corporate Credit Union Network Standards and Guidelines, by which the corporate credit unions voluntarily regulate themselves. Other requirements, such as loan policies, are being done under standard business practices. Several of the reports that will be required by this regulation will not add significantly to the paperwork burden, since they are currently being prepared by corporate credit unions.

Paperwork requirements will be submitted to the Office of Management and Budget for review under the Paperwork Reduction Act. Written comments on these requirements should be forwarded directly to the OMB Desk Officer at the following address: OMB Reports Management Branch, New Executive Office Building, room 3208, Washington, DC 20530, ATTN: Jerry Waxman. A notice of OMB approval will be published in the **Federal Register** once it is received.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. It states that: "Federal action limiting the policy-making discretion of the states should be taken only where constitutional authority for the action is clear and certain, and the national activity is necessitated by the presence of a problem of national scope." The issue of corporate credit unions and their risks to federally insured credit unions are concerns of national scope. This regulation has been enacted in order to enable NCUA and the NCUSIF to have an operable mechanism in place to ensure the safety and soundness of federally insured credit unions. This regulation will apply to all federally insured corporate credit unions. The NCUA Board believes that the protection of the National Credit Union Share Insurance Fund warrants these new restrictions and that the increased restrictions in the final amendments will not unduly burden federally insured state-chartered corporate credit unions. This rule does not impose additional costs or burdens on the states, nor does it affect the state's ability to discharge traditional state government functions. The benefits provided and protection afforded by the NCUSIF are the same for federally insured state-chartered corporate credit unions as for federally, chartered corporate credit unions. It is protection afforded through a federal system. The responsibility for administering that system lies with the NCUA Board. The NCUA Board believes that all federally insured corporate credit unions should be subject to the same requirements. The NCUA Board, pursuant to Executive Order 12612, has determined that this rule may have an occasional direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. Further, the rule may supersede provisions of state law or regulation concerning federally insured state-chartered corporate credit unions which do not substantially meet the requirements of part 704. However, the potential risk to the NCUSIF without these changes justifies them.

List of Subjects

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on May 7, 1992.

Becky Baker,

Secretary of the Board.

☆U. S. GOVERNMENT PRINTING OFFICE : 1992 O - 306-704

EXHIBIT 3
DATE 1-21-93
HB 182

HOUSE BILL 182

Testimony of:
Myrtle A. White

Vice President, Financial Services
Montana Credit Union League

Chief Operating Officer
Treasure State Corporate Central Credit Union

Mr. Chairman, members of the Committee, I am Myrtle White, Vice President-Financial Services for the Montana Credit Unions League, and Chief Operating Officer for Treasure State Corporate Central Credit Union.

My testimony will consist of general information about Treasure State Corporate Central Credit Union, its position and its services, the purpose and intent of NCUA's new regulation for corporate credit unions, and further information on selected sections of the proposed bill.

I. GENERAL INFORMATION

Treasure State Corporate Central Credit Union (TSCCCU) was chartered by the state of Montana in February 1977. TSCCCU serves 92 natural person credit unions and several related organizations with investment liquidity and correspondent financial services.

At December 31, 1992, TSCCCU's assets totaled $159 million. Because ours is a truly wholesale operation with sophisticated data processing services, we operate with a staff of 4 persons in the same physical offices as the Montana Credit Unions League.

Our member credit unions have invested approximately 40% of their investible funds in various types of accounts offered at TSCCCU.

Although at this time there is little need for loans, each credit union has an approved line of credit with TSCCCU to cover short term borrowing needs as their liquidity dictates.

TSCCCU offers other types of financial services, such as electronic transfer of funds and serving as a processor for automated clearinghouse items.

TSCCCU also serves as credit unions' access to the Federal Reserve Bank, offering several correspondent financial services through them. These include daily deposits, cash delivery, and the processing and truncation of business checks.

II. PURPOSE AND INTENT

As you might well imagine, the critical Savings and Loan crisis has spurred our Congress to scrutinize all financial institutions more closely. Pressure has been put

upon regulators of financial institutions to more closely oversee their operations and develop regulations and procedures to assure safety to the depositors and prevent further costs to the taxpayers.

NCUA felt the corporate credit union system needed a regulation which would recognize and identify corporate credit unions' unique position within the credit union system.

The regulation was almost two years in the making. NCUA solicited input from the corporate credit union community and issued a draft regulation twice for comment. The final regulation is indeed a product of the regulator and the regulated working in concert.

III. SELECTED PROVISIONS

New Section 5. Membership Capital Share Deposits.

Bob Pyfer touched on this section in his report. In essence, this would allow TSCCCU to issue at-risk shares, subordinated to all other liabilities in order to increase the corporate's capital base.

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HB 182

TSCCCU has offered a membership shares account to member credit unions asking them to support TSCCCU with a permanent deposit of 1% of their year-end assets, to be updated annually. 89 member credit unions currently support this voluntary account.

For many years corporate credit unions have encouraged NCUA to recognize the permanence of membership shares accounts and allow them to be considered capital. In proposed Section 5, which is nearly verbatim from the federal regulation definition, NCUA is recognizing membership shares accounts and classifying them as capital if they meet certain criteria defined here.

It is important for TSCCCU to have the authority to issue Membership Capital Share Deposits and use them as secondary capital, as many limitations described in the regulation are tied to the corporate credit union's capital.

New Section 7. Corporate Reserves.

Until the adoption of the new NCUA regulation for corporate credit unions, TSCCCU fell under the reserve requirements of our current state credit union law. This law requires credit unions to reserve a percentage of gross income, varying according to the regular reserve account as compared to the credit union's risk assets. Because TSCCCU has so few risk assets, we have not been required to reserve for some time.

However, recognizing that building reserves and capital makes good business sense, TSCCCU has added to its reserves consistently.

NCUA, in adopting the new regulation, has recognized that reserving on gross income is not appropriate for corporate credit unions. As interest rates fluctuate, gross income can decline dramatically. Additionally, corporate credit unions' assets can grow or shrink substantially in a short period of time. Therefore, the new NCUA regulation requires corporate credit unions to reserve based on a percentage of their average monthly assets.

Additionally, NCUA recognizes that some assets present more of a risk to a corporate credit union than others. And, as Bob stated in his testimony, they have provided a schedule of different types of assets and how much they must be risk weighted.

The regulation will allow us to use membership capital share deposits in an equal amount to primary capital (regular reserves and undivided earnings) to apply to the necessary capital ratio required. TSCCCU will meet all capital requirements.

Mr. Chairman and members of the Committee, this concludes my formal testimony on the bill. I would be happy to respond to questions from the Committee.

We urge the Committee to recommend "do pass" for House Bill 182. Thank you.

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EXHIBIT 4
DATE 1-21-93
HB 165

Amendments to House Bill No. 165
First Reading Copy

For the Committee on Business and Economic Development

Prepared by Paul Verdon
January 21, 1993

1. Title, lines 6 and 7.
Strike: "PROVIDING FOR THE COUNTY ATTORNEY TO PROSECUTE VIOLATIONS;"

2. Page 4, lines 8 through 14.
Strike: Section 4 in its entirety
Renumber: subsequent sections

3. Page 3, lines 20 and 23.
Strike: "5"
Insert: "4"

HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Business & Ec COMMITTEE BILL NO. SB 182

DATE Jan 21, 1993 SPONSOR(S) B. Bachini

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NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
Larry Heggen	Laurel Federal Credit Union	X	
Gene Bowen	Helena Community FCU	X	
Bob Pyfer	MT Credit Unions League	X	
Myrtle White	Mt. Credit Union League	X	
Donald Hutchinson	State of MT Financial Division	X	
Michelle Green	Dept. of Commerce		

PLEASE LEAVE PREPARED TESTIMONY WITH SECRETARY. WITNESS STATEMENT FORMS ARE AVAILABLE IF YOU CARE TO SUBMIT WRITTEN TESTIMONY.

HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Business COMMITTEE BILL NO. HB 165

DATE 1-21 SPONSOR(S) Rep W Larson

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NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
Bonna Alexander Bozeman 59624	MT/Wyoming Oregon Gas Assn.	X	
Gary South, P.O. Box 5745 Helena	Northern Energy Inc.	X	
Daryl South 3280 HWY 12 East Helena	Montana Propane	X	
Jack Mulcare Lincoln MT P.O. Box 69	Western Fuel Inc.	X	
DAN BEAVERS	NEE - GREAT FALLS	X	
Chris Bowers	Northern Energy - Bozeman	✓	
Louis LAIRD	Suburban / Petrolane	✓	
Larry Messerli	Suburban / Petrolane	✓	
J.A. (Jack) Brown	Suburban / Petrolane	✓	
JAY COOK	NORTHERN ENERGY	✓	
George Krauss	Northern Energy	✓	
Gerald Rogers	Northern Energy	✓	

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