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NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

August 8, 1988

Office of General Counsel

Walter Polner
ASCU
P.O. Box 5488
Madison, Wisconsin 53705

Re: Deferred Compensation, IRA, and 403B Accounts (Your April 5, 1988, Letter)

Dear Mr. Polner:

Enclosed are materials on deferred compensation, pension, and/or retirement accounts. We hope they will be helpful.

Sincerely,

TIMOTHY P. McCOLLUM
Assistant General Counsel

TPM:sg

FOIA Ltr. II (F) Pension Activities

audit shall be made using generally accepted auditing procedures and standards. However, each Federal credit union's annual audit shall, as a minimum, test the Federal credit union's assets, liabilities, equity, income, and expenses for existence, proper cut off, valuations, ownership, disclosures and classification, and internal controls. Upon completion, a report of the audit shall be made promptly to the board of directors of the Federal credit union and, upon request, of the National Credit Union Administration's regional director. It is the responsibility of the supervisory commitee to ensure that the completion of the annual audit is timely, that generally accepted auditing procedures are used, that adequate audit of the credit union records is made, and that the audit report is promptly prepared and reported to the board of directors.

(c) The supervisory committee and or its independent auditors shall be responsible for the preparation and the maintenance of workpapers used to support each audit. Such workpapers shall be made available by the supervisory committee and its independent auditors for review by any authorized employee of the National Credit Union Administration.

(d) Federal credit union compensated auditors, performing audits for superisory committees, must be independent of the credit union's employees, members of the board of directors, supervisory and credit committees and or the credit union's loan officers, and members of their immediate families. "Members of their immediate families" means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or the spouse of any such individual.

(e) The verification of members' accounts shall be made using any of the following methods:

(1) A controlled verification of 100 percent of members' share and loan accounts;

(2) A controlled random statistical sampling method that accurately tests sufficient accounts in both number and scope to provide assurance that the General Ledger accounts are fairly stated and that members' accounts are properly safeguarded. The sampling procedure must provide each member account an equal chance of being selected.

Records of those accounts verified will be maintained and will be retained until the next verification of members' accounts is completed.

§701.13 Deleted December 1987.

§701.14 Deleted May 1982.

§701.15 Deleted June 1979.

§701.16 Deleted December 1981.

§701.17 Deleted December 1981.

§701.18 Deleted December 1981.

§701.19 Retirement Benefits for Employees of Federal Credit Unions.

(a) A Federal credit union may make provision for reasonable retirement benefits for its employees and for officers who are compensated in conformance with the Act and the bylaws, either individually or collectively with other credit unions. In those cases where a Federal credit union is to be a plan trustee or custodian, the plan must be an individual retirement account maintained in accordance with the provisions of Part 724. Where the trustee or custodian is a party other than the Federal credit union, the employee benefit plan must be maintained in accordance with the applicable laws governing employee benefit plans and such rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other Federal or state authority exercising jurisdiction over such plans.

(b) No Federal credit union shall occupy the position of a fiduciary, as defined in the Employee Retirement Income Security Act of 1974 and rules and regulations promulgated thereunder by the Secretary of Labor, unless provision has been made for appropriate liability insurance as provided under Section 410(b) of the Employee Retirement Income Security Act of 1974.

§701.20 Fidelity Bond and Insurance Coverage for Federal Credit Unions.

(a) *Scope.* This Part provides the requirements for fidelity bonds for Federal credit union employees and officials and for general insurance coverage for losses caused by persons outside of the credit union (protection for losses due to theft, holdup, vandalism, etc.).

(b) *Review of Coverage.* The board of directors of each Federal credit union shall, at least annually,

Part 724

Trustees and Custodians of Pension Plans

§724.1 Federal Credit Unions Acting as Trustees and Custodians of Pension Plans

A Federal credit union is authorized to act as trustee or custodian, and may receive reasonable compensation for so acting, under any written trust instrument or custodial agreement created or organized in the United States and forming part of a pension plan which qualifies or qualified for specific tax treatment under section 401(d) or 408 of the Internal Revenue Code, for its members or groups or organizations of its members, provided the funds of such plans are invested in share accounts or share certificate accounts of the Federal credit union. All funds held in a trustee or custodial capacity must be maintained in accordance with applicable laws and rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other authority exercising jurisdiction over such trust or custodial accounts. The Federal credit union shall maintain individual records for each participant which show in detail all transactions relating to the funds of each participant or beneficiary.

§724.2 Appointment of Successor Trustee or Custodian

The plan shall provide for the appointment of a successor trustee or custodian by a person, committee, corporation or organization other than the Federal credit union or any person acting in his capacity as a director, employee or agent of the Federal credit union, upon notice from the Federal credit union or the Board that the Federal credit union is unwilling or unable to continue to act as trustee or custodian.

NATIONAL CREDIT UNION ADMINISTRATION

Trustees And Custodians of Pension Plans

Interpretive Ruling and Policy Statement Number 85-1

AGENCY: National Credit Union Administration (NCUA)

ACTION: Interpretive Ruling and Policy Statement Number 85-1

SUMMARY: The NCUA Board has determined that Federal credit unions (FCU's) may offer self-directed IRA and Keogh accounts and act as the custodians of such accounts.

EFFECTIVE DATE: November 14, 1985

COMMENTS: Although this is a final ruling, comments will be accepted until January 20, 1986. Send comments to Rosemary Brady, Secretary, NCUA Board, 1776 G Street, N.W., Washington, D.C. 20456. The NCUA Board will review all comments and determine whether substantive amendments to this ruling or amendments to NCUA's regulations are appropriate.

FOR FURTHER INFORMATION CONTACT: Steven Bisker, Assistant General Counsel, or Yvonne Gilmore, Staff Attorney, at the above address, or telephone (202) 357-1030.

SUPPLEMENTARY INFORMATION:

The NCUA Board has determined that FCU's may offer and act as custodians for self-directed IRA and Keogh accounts. Part 724 of NCUA's Rules and Regulations (12 C.F.R. Part 724) authorizes FCU's to act as trustee or custodian of IRA and Keogh accounts (established, respectively, pursuant to the Employee Retirement Income Security Act of 1974 ("ERISA") and the Self-Employed Individual Retirement Act of 1962) of its members where the funds are invested in shares and share certificates of the credit union. However, Part 724 does not state whether, as custodians of such accounts, FCU's may, at the direction of the member, facilitate transfers of funds to other assets. This Interpretive Ruling and Policy Statement clarifies the authority of FCU's to perform that service for their members, i.e., to serve as custodians for self-directed IRA and Keogh accounts.

Part 724 of the NCUA Rules and Regulations was first promulgated in 1975 as Section 721.4. The preamble to that Section expressly acknowledged that IRA and Keogh plans established at FCU's were limited to investments of funds in share and share certificate accounts at the FCU until issues concerning other possible investment activity were resolved. 40 Fed. Reg. 25582 (June 17, 1975).

The primary issue requiring further study was that of the legal authority of Federal credit unions to serve as trustee or custodian of IRA and Keogh plans wherein funds are invested in assets other than share or share certificate accounts in the credit union. This issue arises from the fact that Federal credit unions do not have general, discretionary trust powers. The Employee Retirement Income Security Act, however, recognizes federally insured credit unions as being among the qualifying trustees or custodians of IRA and Keogh trusts, for purposes of the individual accountholder obtaining certain tax benefits, and does not limit the investment of trust funds to share and share certificate accounts of the credit union. (See 26 U.S.C. §§401(d), 408(a) and (h).) Further, Section 207(c)(3) of the Federal Credit Union Act (12 U.S.C. §1787(c)(3)) addresses insurance coverage of IRA and Keogh retirement accounts at federally insured credit unions, thus separately establishing the authority of Federal credit unions to offer IRA and Keogh accounts when the funds are invested in shares and share certificates in the credit union. NCUA has determined that these provisions, read together, provide sufficient authority for Federal credit unions to offer and serve as trustee or custodian of IRA and Keogh accounts where all funds are initially deposited to a share or share certificate account at the credit union and any subsequent transfers to other assets are solely at the discretion and direction of the credit union member establishing the account. Such activity is both incidental to the FCU's authority to offer IRA and Keogh share accounts and is also

consistent with ERISA's recognition of insured credit unions as qualifying custodians, for tax purposes, of IRA and Keogh trusts.

As stated in the text of NCUA's Interpretive Ruling, set forth below, the establishment of self-directed IRA and Keogh accounts at FCU's will require an FCU to engage only in custodial duties with no exercise of investment discretion. Further, the FCU will not be permitted to provide investment advice. The FCU will simply arrange for the purchase or sale of assets upon the instructions of the member. The IRA or Keogh participant will bear the risks of his investment decisions. Additionally, it is noted that the part of the IRA or Keogh account invested in other than shares or share certificates at the FCU will not be insured by the National Credit Union Share Insurance Fund. The FCU shall take appropriate measures to ensure that this fact is understood by the member.

Although this IRPS does not mandate specific requirements concerning recordkeeping and segregation of assets, FCU's must operate in accordance with applicable laws and regulations governing IRA and Keogh trust accounts and consistent with principles of sound custodial (trust) administration, including the segregation and/or adequate identification of corresponding assets of IRA and Keogh accounts, whether held by the credit union or, under a contractual safekeeping arrangement, with a third party. An FCU should take steps to assure that individual member account records reflect all assets bought and sold on behalf of the member. In addition, an FCU should maintain proper records to verify, among other things, the account for which each

transaction was effected, a description of the asset, the purchase (or sale) price of the asset, the trade date, and the name or other designation of the broker-dealer or other person (entity) from whom the asset was purchased or sold. Such information will also be used, in part, in preparation of forms required to be filed with the Internal Revenue Service by all custodians and trustees of IRA and Keogh accounts.

It is not NCUA's intention, through this interpretative ruling, to authorize FCU's to handle member orders to buy or sell securities or to otherwise engage in activities that would require registration by the FCU as a broker-dealer and trigger related responsibilities under Securities and Exchange Commission (SEC) regulations and Federal securities laws. Thus, in order to offer self-directed Ira and Keogh accounts to members, and to serve as custodian for such accounts, it will be necessary for the FCU to have an arrangement with a securities broker-dealer, pursuant to which the broker-dealer receives all buy and sell orders from the member and executes the securities trade.

A review of previous SEC "no action" letters with respect to FCU involvement in brokerage-related activities indicates that FCU's may solicit members to participate in self-directed IRA or Keogh accounts, and will not be required to register, provided that: (1) the FCU does not exercise investment discretion or render investment advice, (2) the broker-dealer performs all brokerage functions and is clearly identified as the one performing such functions, and (3) FCU employees perform only clerical and ministerial functions. Clerical and ministerial

functions would include distributing promotional materials to members, assisting members in completing account opening forms, and effecting debits or credits to the member's share account related to the purchase and sale of securities and receipt of dividend income from the securities.

Lastly, under SEC rules, an FCU could share in commissions and, assuming the FCU satisfies the conditions described above, it would not have to register as a broker-dealer. However, Part 721 of the NCUA Rules and Regulations (12 C.F.R. Part 721), concerning FCU insurance and group purchasing activities, would limit the amount of compensation that an FCU could receive. In performing its administrative (ministerial) functions in the execution of its members' buy and sell orders, an FCU could only be reimbursed for its direct and indirect costs related to the administrative services it provides.

INTERPRETIVE RULING AND POLICY STATEMENT 85-1

Trustees and Custodians of Pension Plans

A Federal credit union may act as trustee or custodian of individual retirement plans of its members established pursuant to the Employee Retirement Income Security Act of 1974 or self-employed retirement plans established pursuant to the Self-Employed Individuals Retirement Act of 1962, provided that:

1) all contributions of funds are initially made to a share or share certificate account in the credit union;

2) any subsequent transfer of funds to other assets is solely at the direction of the member and the Federal credit union exercises no investment discretion and provides no investment advice with respect to plan assets (i.e., the credit union performs only custodial duties);

3) the member is clearly notified of the fact that National Credit Union Share Insurance Fund coverage is limited to funds held in share or share certificate accounts of NCUSIF-insured credit unions; and

4) the Federal credit union complies with all applicable provisions of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations, and applicable laws and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other authority exercising jurisdiction over such trust or custodial accounts.

By the National Credit Union Administration Board on November 14, 1985.

Rosemary Brady

ROSEMARY BRADY
Secretary of the Board

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

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Mr. Ronald C. Martin
President/Treasurer
Technology Federal Credit Union
P.O. Box 7236
605 Ellis Street
Mountain View, CA 94039

Dear Mr. Martin:

This is in response to your letter of June 29, 1984, concerning a 401k deferred compensation program.

The first issue that you raise is whether or not a Federal credit union (FCU) can act as a trustee/custodian and plan administrator of a 401k deferred compensation plan. The FCU Act has been interpreted to grant FCU's limited trustee powers. Pursuant to Sections 119 (which allows shares to be issued in trust) and 107(15) (the incidental powers clause) of the FCU Act, 12 U.S.C. §§1765 & 1757(15), an FCU may act as a trustee for passive trusts for which a trustee has no discretionary duties. In this regard, FCU's have been specifically authorized by regulation to serve as trustee or custodian of a trust or custodial agreement that forms part of a pension plan qualifying for specific tax treatment under Section 401(d) or 408 of the Internal Revenue Service (IRS) Code. See Part 724 of NCUA Regulations, 12 C.F.R. Part 724. According to the regulation, FCU's may only serve as trustee for a 401(d) or 408 plan. Therefore, it is impermissible for an FCU to serve as trustee for a 401k plan under the present regulations. Since an FCU cannot serve as a trustee for a 401k plan, your question concerning direction of investments becomes moot. It should be noted that even in cases where an FCU can act as trustee (under a 401(d) or 408 plan) it can serve in a passive capacity only. As trustee the FCU may not direct funds into third party investments. According to Part 724, the funds must be invested in share accounts or share certificate accounts of the FCU. This is due to the fact that FCU's are not granted general trust powers.

In your letter you mention Part 745 of the NCUA Regulations, 12 C.F.R. Part 745, although you do not specifically ask about insurance of deferred compensation accounts. According to sections 745.2 and 745.9-3 of the regulations, deferred compensation accounts are insured up to $100,000 as to the interest of each plan participant who is a member of the FCU, separately from other accounts of the participant or the

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employer. The records of the credit union must disclose the plan. Of course, only members may have individual accounts at your FCU.

The last issue that you raise in your letter concerns credit union service organizations (CUSO's). Section 701.27 of the regulations addresses CUSO's. A CUSO primarily provides goods and services and performs functions that are associated with the routine operation of credit unions. According to the regulation, a CUSO may serve as a trustee or in other similar fiduciary capacities. The NCUA does not regulate how the CUSO would direct the plan's investments. Of course, only those funds placed in FCU share or share certificate accounts would be insured by NCUA. As you know, the IRS has separate regulations concerning 401k plans. We do not purport to make a determination as to compliance with the IRS regulations.

We hope that we have been of assistance.

Sincerely,

/S/

ROBERT M. FENNER
Director, Department of Legal Services

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

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Joseph F. Hinchey, Manager
Philadelphia Federal Credit Union
1206 Chestnut Street
Philadelphia, PA 19107

Dear Mr. Hinchey:

This is in response to your letter of October 3, 1984, concerning deferred compensation plans.

You ask about deferred compensation plans under Sections 457 and 401k of the Internal Revenue Service Code. Our answers are the same for either type of plan. Your questions and our answers follow.

1. May a credit union be a depository for such a plan? Yes, an FCU may receive 457 or 401k funds into a share or share certificate account. However, since FCU's have not received a statutory grant of trust powers, an FCU may not serve as the trustee for such plans.

2. If so, are there any limitations or other considerations of which we should be aware, such as restrictions on investing of funds, etc? Yes, since the FCU cannot serve as trustee for a 457 or 401k plan, the funds placed in an FCU account cannot be invested separately from other FCU funds. As you know, FCU's may make investments pursuant to Section 107(7) and (8) of the FCU Act, 12 U.S.C. §1757(7) and (8).

3. Beneficiaries of the government plan include both members and nonmembers of the credit union-does this affect our ability to act as the depository and does it affect insurance of the plan funds? Yes, the status of the beneficiaries of the plan will have an effect on the FCU's ability to act as the depository and the insurance of the funds. In order to create an irrevocable trust account into which the funds will be placed, either the settlor or all of the beneficiaries of the plan must be members of the FCU. According to sections 745.2 and 745.9-3 of the NCUA Regulations, 12 C.F.R. §§745.2 and 745.9-3, deferred compensation accounts are insured up to $100,000 as to the interest of each plan participant (beneficiary) who is a member of the FCU, separately from other accounts of the participant or the employer. The interest of nonmember beneficiaries shall be combined and insured to a maximum of $100,000. The records of the credit union must disclose the deferred compensation plan.

The IRS has separate regulations concerning deferred compensation plans. We do not purport to make a determination as

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to compliance with IRS Code or regulations.

We hope that we have been of assistance.

Sincerely,

RM

ROBERT M. FENNER
Director, Department of Legal Services

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

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SEP 14 1984

Morris L. Horwitz, Esquire
Horwitz and Frankel
1700 Pine Avenue
P.O. 2067 NMS
Niagara Falls, NY 14301

Dear Mr. Horwitz:

This is in response to your letter of August 31, 1984, to Todd Okun, concerning the deposit of 401k moneys in a Federal credit union (FCU).

An FCU may receive 401k funds into a share or share certificate account. The FCU may not serve as trustee for the 401k plan. In order to create an irrevocable trust account, either the settlor or all of the beneficiaries must be members of the FCU. According to sections 745.2 and 745.9-3 of the NCUA Regulations, 12 C.F.R. §§745.2 and 745.9-3, deferred compensation accounts are insured up to $100,000 as to the interest of each plan participant (beneficiary) who is a member of the FCU, separately from other accounts of the participant or the employer. The interest of nonmember beneficiaries shall be combined and insured to a maximum of $100,000. The records of the credit union must disclose the deferred compensation plan.

We hope that we have been of assistance.

Sincerely,

(S)

ROBERT M. FENNER
Director, Department of Legal Services

FOIA file Vol II F 3 Deferred Compensation Plan 401K

NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

July 28, 1987

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Office of General Counsel

Ms. Betsy Hooper
President/CEO
La Capitol Federal Credit Union
P.O. Box 3398
Baton Rouge, LA 70821-3398

Dear Ms. Hooper:

Chairman Jepsen asked that this Office respond to your letter of July 6, 1987, regarding the impact of Internal Revenue Code Section 457 and Internal Revenue Service Notice 87-13 on deferred compensation plans offered by Federal credit unions (FCU's).

Pursuant to the Tax Reform Act of 1986 (TRA), tax-exempt employers, including FCU's, who choose to offer deferred compensation plans must now do so pursuant to Internal Revenue Code Section 457. (Section 457 should be consulted for the effective date and the grandfather provisions pertaining to extension of the Section to plans of tax-exempt organizations.) Prior to the TRA, FCU's could offer deferred compensation plans pursuant to Internal Revenue Code Section 401(k). Internal Revenue Service Notice 87-13 provides guidance with respect to certain provisions of the TRA, including the extension of Section 457 to deferred compensation plans of tax-exempt organizations.

You stated in your letter that Notice 87-13 imposes the following two detrimental restrictions on FCU's. "First, the rank and file of credit union employees is denied membership in what must be only a kind of "top hat" retirement plan. Secondly, the notice requires that accumulated annual leave and other accrued non-elective benefits be included under the computation of maximum annual deferral limits." You asked that these problems be corrected through the hearings on technical corrections to the TRA currently before Congress.

It is our understanding that it is the Department of Labor's ERISA statutes, rather than Section 457 itself, that result in the fact that, under section 457, tax-exempt organizations will be restricted to offering deferred compensation plans to a select group of management or highly-compensated employees. Therefore,

NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

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July 2, 1987

Office of General Counsel

Ms. Barbara Chastain
Vice President Personnel
S.A.F.E. Federal Credit Union
P.O. Box 1057
North Highlands, California 95660-1057

Dear Ms. Chastain:

This is in response to your letter of April 27, 1987, regarding the permissibility of Federal credit unions (FCU's) providing deferred compensation benefits to their employees.

Section 701.19(a) of the NCUA Rules and Regulations provides, in part, that an FCU may make provision for reasonable retirement benefits for its employees. By virtue of this provision, an FCU has the authority to establish a deferred compensation plan for its employees. Section 701.19 further states that if the FCU is the custodian or trustee of an employee benefit plan, the plan must be an individual retirement plan maintained in accordance with the provisions of Section 724.1 of the NCUA Rules and Regulations. Section 724.1 provides that an FCU may be a trustee or custodian of a pension plan qualifying under Section 401(d) or Section 408 of the Internal Revenue Code. These sections provide for IRA and Keogh plans. If the FCU is not the plan trustee or custodian, an individual retirement account need not be established in share or share certificate accounts at the FCU.

We have previously stated that an FCU does not have the authority to invest the funds used to establish the deferred compensation plan on behalf of the employees that are covered by the plan. This position was based upon the fact that FCU's do not have general trust powers, and to the extent that the FCU invests funds on behalf of employees, it would be operating as a trustee.

While an FCU may not invest the deferred compensation funds on behalf of an employee, we have recently opined that FCU's can purchase annuities pursuant to the terms of a deferred compensation agreement where the FCU was both the owner and beneficiary of the annuity. As you know, Section 107(7) of the FCU Act provides the investment authority for FCU's. This section would not permit FCU's to invest in annuities for their own account. In determining that the FCU could purchase an

FCU 6.1.H F3 Deferred Compensation Plans

annuity under the above described circumstances, we recognized that the FCU was not purchasing the annuity as an investment for its own account. Instead, the FCU was acting pursuant to its authority to provide retirement benefits, and was therefore not limited by Section 107(7).

The determination that FCU's could purchase annuities under the circumstances described herein reverses a prior opinion of this office on a similar issue. In the prior opinion, we concluded that this type of purchase was impermissible on either one of two legal theories. First, we stated that the purchase constituted an impermissible investment under Section 107(7). Alternatively, we concluded that, in reality, the FCU was acting as a trustee, i.e., the FCU was holding the investment as trustee on behalf of the employee/beneficiary. As stated above, an FCU does not have the authority to serve as a trustee under these circumstances. The prior opinion did not consider whether the investment was permissible pursuant to the FCU's authority to provide retirement benefits which is the basis of our recent opinion on this issue.

Lastly, we suggest that, in establishing a deferred compensation plan, you or the FCU attorney review the pertinent Internal Revenue Code sections and regulations.

We trust this has been of assistance.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

JT:sg