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NATIONAL CREDIT UNION ADMINISTRATION  
Washington, D.C. 20456

February 3, 1989

Office of General Counsel

Mr. Dennis L. Doll  
Depository Manager  
Adams - Van Dyke, Inc.  
3601 SW 29th Street  
Suite 125  
Topeka, Kansas 66614

Re: Nonmember Deposits (Your January 4, 1989,  
Letter)

Dear Mr. Doll:

You asked six questions concerning the authority of federally-insured credit unions to accept nonmember deposits and how these deposits are insured. Your questions and our answers thereto follow.

1. "Can a limited income Credit Union (as defined by the Board) take deposits from any source outside of their membership and still provide NCUA insurance on these deposits up to the \$100,000 limit?"

Federal credit unions ("FCU's") (those chartered by the NCUA) may receive a designation from the NCUA as serving "predominantly low income members" (as defined in Sections 700.1(h) and (i) of the NCUA Rules and Regulations (12 C.F.R. §§700.1(h) and (i))). These FCU's may accept deposits from any source outside of their membership pursuant to Section 107(6) of the FCU Act (12 U.S.C. §1757(6)). Such accounts, if properly accepted and maintained, are insured by the National Credit Union Share Insurance Fund ("NCUSIF") up to the \$100,000 limit as if they were member accounts.

The NCUA Board recently issued an interim final rule limiting the amount of nonmember and public unit

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accounts that FCU's may maintain to 20 percent of total shares. Any amount in excess of the 20 percent must be approved by the NCUA. (See new Section 701.32 of the NCUA Rules and Regulations, enclosed.)

~~2a. "Can this same CU pay brokerage commissions in order to obtain these deposits?"~~

FCU's are not legally restricted from paying brokerage commissions. However, a number of recent case histories has shown that FCU's obtaining brokered deposits have suffered severe safety and soundness problems and have caused losses to the NCUSIF. Therefore, FCU's obtaining brokered deposits will be closely monitored. Limits on such brokered deposits may be imposed by the NCUA if safety and soundness concerns warrant them.

2b. "Are these deposits insured to the limit of NCUA insurance coverage?"

As stated in our answer to question 1. above, such deposits, if properly accepted and maintained, are insured as member accounts by the NCUSIF up to the \$100,000 limit.

3a. "Is a non-limited income CU allowed to bring in deposits from other Credit Unions or Non-Members?"

All FCU's have the authority to accept certain types of nonmember accounts. Section 107(6) of the FCU Act (12 U.S.C. §1757(6)) authorizes all FCU's to receive payments on accounts from other credit unions and nonmember units of Federal, Indian Tribal, State, or local governments and political subdivisions thereof (public units). The interim final rule discussed above under question 1. applies to all nonmember (including nonmember credit union) and public unit accounts.

3b. "Are these deposits insured to the limit of \$100,000 as provided by the NCUA?"

These deposits are insured up to \$100,000 per account by the NCUSIF if properly accepted and maintained.

3c. "Can a non-limited income CU pay brokerage commissions to obtain these deposits?"

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Yes, see the answer to question 2a.

I hope that we have been of assistance.

Sincerely,

*Hattie M. Ulan*  
for

HATTIE M. ULAN  
Acting Assistant General Counsel

HMU:sg  
Enclosure

# RULES & REGULATIONS

DECEMBER 14, 1988

**NATIONAL CREDIT UNION ADMINISTRATION**

12 CFR Parts 701 and 741

Nonmember and Public Unit Accounts

**AGENCY:** National Credit Union Administration**ACTION:** Interim Final Rule

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**SUMMARY:** This amendment adds a new provision to Part 701 limiting the amount of public unit and nonmember accounts that may be maintained by Federal credit unions to 20 percent of total shares. To the extent that federally-insured state-chartered credit unions are authorized to accept such accounts, a new amendment to Part 741 would provide the same limitation. Exceptions to the limitation may be obtained from the appropriate NCUA Regional Director when warranted. The NCUA has determined that the accumulation of large amounts of public unit and nonmember funds, amounts far in excess of that needed to provide services to a credit union's members, results in an unsafe and unsound condition, poses substantial risks to the credit union system and the National Credit Union Share Insurance Fund, and has already caused significant losses to both the Fund and credit unions.

In addition, although no specific language is included in this document, the NCUA Board is considering a proposal to require any federally-insured credit union that accepts nonmember accounts to obtain an annual CPA audit and disclose the audit to its nonmember accountholders. The Board requests comments on this issue as well as the interim final amendment.

**EFFECTIVE DATE:** December 19, 1988. Comments must be received on or before February 20, 1989.

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

**FOR FURTHER INFORMATION CONTACT:** D. Michael Riley, Director, Office of Examination and Insurance, or James J. Engel,

Deputy General Counsel, at the above address or telephone:  
(202) 682-9640 (Mr. Riley) or 682-9630 (Mr. Engel).

#### SUPPLEMENTARY INFORMATION:

##### Scope

The limitation contained in this amendment applies to all Federal credit unions that accept accounts of public units and nonmembers, including nonmember credit unions. Generally, public unit accounts will be nonmember accounts. (For purposes of this discussion the term "account" means a share, share certificate, or share draft account.) It also applies to those Federal credit unions that, having been designated low-income credit unions by NCUA, maintain accounts for other nonmembers in addition to credit union and public unit accounts. To the extent any federally-insured state-chartered credit unit is authorized to accept public unit and nonmember accounts, the limitation is applicable to them as well.

Although corporate credit unions are subject to the 20% limitation, due to the fact that the majority of their accounts are from member credit unions, this amendment should have little effect on their operations.

Federally-insured credit unions are also authorized to act as depositories and fiscal agents of the U.S. Treasury and maintain special accounts on its behalf. See 12 U.S.C. §§1767 and 1789a; 12 C.F.R. §§701.37-1 and 701.37-2. This amendment does not apply to or affect those accounts.

##### Background

All Federal credit unions are authorized to accept and maintain certain types of nonmember accounts. Section 101(5) of the Federal Credit Union Act ("the Act"), 12 U.S.C. §1752(5), defines "member account" to include, *inter alia*, the accounts of nonmember credit unions and the accounts of nonmember units of Federal, state, or local governments and the political subdivisions of such units. The term also includes -- but only in the case of a credit union that serves predominantly low-income members and that has received a low-income designation from NCUA -- accounts of any nonmember. The terms "predominantly" and "low-income members" are defined in Part 700 of NCUA's regulations. Thus, NCUA designated "low-income" Federal credit unions

can accept accounts from any nonmember, whereas other Federal credit unions can only accept nonmember accounts from other credit unions or public units.

### Discussion

It is important to realize that the authority to accept nonmember accounts does not include the authority to provide credit union services to nonmembers. The funds maintained in nonmember accounts are to be used only for the purpose of serving the credit union's membership. Nonmember accounts are not designed to merely expand a credit union's share base or to simply provide another investment medium for large accountholders. They are to be used to fund the basic purpose of credit unions: *promoting thrift and creating a source of credit for the members*, whether in the form of loanable funds or through increased earnings on investments that in turn are paid out to members in the form of dividends.

The NCUA's concern with nonmember accounts stems from the fact that such accounts tend to represent large sums of money, often in excess of the \$100,000 insurance limit, invested by both public units and institutional investors. In most credit unions, it is only the public unit accounts that come into play. In low-income credit unions, however, both public units and institutional investors can establish accounts. These large accounts have traditionally been sensitive to interest rate fluctuations. In order to keep these accounts, some credit unions have had to pay higher than market dividend rates. Large influxes of funds into credit unions cause asset/liability management problems that are often not within management's expertise to control. In some cases, the total amount of such accounts is far in excess of the amount necessary to meet the legitimate needs of members and is used to fund high risk loans -- often to insiders -- and questionable investments. As in the problem case credit unions identified below, we have seen management aggressively pursuing these types of accounts.

These practices have a direct bottom line effect on all federally-insured credit unions. Money from the National Credit Union Share Insurance Fund ("Fund") that would otherwise be used to build Fund equity or pay dividends to credit unions on their 1% Fund deposit is used to cover losses sustained due to liquidations and mergers. The credit union system also suffers when large accountholders, primarily public units, sustain

losses on accounts in excess of the insurance limit. The public units suffer the monetary loss; credit unions suffer from a loss in confidence. The investment managers of these public units don't make distinctions between credit unions. Their future investments will go to a different market.

Past experience - problem cases.

Franklin Community FCU - Losses to the Fund may exceed \$40 million. We estimate that accountholders will lose between \$2.5 and \$3 million because of amounts in excess of the \$100,000 insurance limit.

Zionic FCU - Cost the Fund \$4.5 million to liquidate. Nonmember accounts totalled \$18 million as compared to \$250,000 in member accounts.

American Free Enterprise FCU - Merged with another credit union at a cost of \$898,000.

New American FCU - Liquidated at a cost of \$3.1 million.

United Methodist FCU - Liquidated at a cost, to date, of \$2.3 million.

Financial Services CU - Cost to liquidate in excess of \$1 million.

Center Place Savings CU - A purchase and assumption cost the Fund \$150,000.

While the total of the above losses may, at first glance, appear to be within acceptable limits when considering the overall size of the Fund and the insured credit union system, it is not. These are losses resulting solely from the utilization of a legitimate authority in an unsafe and unsound manner for purpose beyond the authority's design and intent. Credit unions expect their Fund to be used to cover legitimate insurance risks, e.g., losses caused by economic conditions. They should find losses such as those caused by mismanagement and misuse of authority, particularly when it places the system in a bad light, to be intolerable. The Fund has a statutory duty to protect members, but it also has responsibility to the credit unions it insures to take steps to reduce losses when there are means within its control. This amendment is such a step.

The purpose of the 20% limitation contained in this amendment is to control the amount of these nonmember funds that flow

into credit unions. For the most part, there should be no real affect on the majority of credit unions. The amendment recognizes that a credit union may have the ability to manage funds in excess of that proposed and may have a legitimate need for exceeding the limit. Some military credit unions, for example, act as the local base depository and may exceed the 20% cap in performing that function. A credit union can seek an exemption from the appropriate NCUA Regional Director. It will have to provide an explanation of a need for the exemption and provide the Region with a copy of its loan and investment policies.

In selecting the 20% figure, NCUA looked to past practice. From May 1975, through April 1982, Federal credit unions were permitted to accept up to a total of 20% of assets in public unit accounts; no more than 5% from any one public unit. The NCUA Board proposed expanding the limits in November, 1981. The issue generated only eight comments, all in favor of the proposal but none of them indicating that the limits then in effect were burdensome or otherwise causing any problems for credit unions. The Board decided to eliminate the limits altogether but cautioned, "... volatile share capital such as public unit funds should be balanced with short-term liquid assets in which the credit union earns a positive return." 47 FR 17979 (April 27, 1981).

Although the 20% limit in this amendment is based on shares as opposed to total assets, the Agency does not believe that this represents a material difference. The previous asset-based limitation imposed no hardship on credit unions. Individual situations will be addressed by the Regional Directors upon application of the affected credit unions.

#### Effective Date - Interim Rule - Comment Period

Although this amendment is being issued as an interim final rule and is effective immediately, the NCUA Board encourages credit unions to submit comments. Comments may be submitted on or before February 20, 1989.

The Board finds it necessary and appropriate to act quickly in this matter in order to limit further losses and reduce additional risk. Such losses affect all federally-insured credit unions due to their interest in the Fund and the need to maintain confidence in the system. Any delay in the effective date of this rule is contrary to the best interests of federally-insured credit unions. It is expected, however, that this rule will have no restraining effect on the operations of the vast majority of credit unions. Those credit unions that currently exceed the 20% limit need only



notify their NCUA Regional Director and then, within 60 days, either request an exemption or provide a statement that they are in compliance.

## State Regulators

As previously mentioned, this interim amendment applies to those federally-insured state chartered credit unions that accept public unit and nonmember accounts. Therefore, during the 60 day comment period, the Board intends to work with the State credit union regulators to obtain their guidance regarding their participation in the administration of the rule. The NCUA Board specifically requests their comments and recommendations on this rule and on the proposal set forth below.

## Request for Comments

The NCUA Board is also requesting comments on a related issue currently being considered. The issue is whether or not all federally-insured credit unions that accept nonmember accounts should be required to obtain annual CPA audits and disclose the audits to the nonmember accountholders. In choosing to accept such accounts, a credit union opens itself as an investment medium to a broader constituency and may be assuming an obligation beyond that owed to its members. Such a requirement not only benefits the nonmember accountholders but also, and more importantly, it will, in the long run, benefit the entire credit union system.

As previously mentioned, the largest nonmember accounts are rate sensitive. Frequently, these nonmembers do not analyze the institutions into which they place their funds as long as it is federally insured and is paying the highest available rate. Although this may be their own shortcoming, when they suffer losses they tend to look to other industries or markets for fund placement. This removes those credit unions that can adequately manage these funds, and may well need them to meet their own member's needs, from being considered as a viable investment option. Disintermediation occurs and the credit union system is the loser.

If credit unions wish to compete for these funds, they must be willing to accept additional responsibilities. The fact that CPA audits are required and available can only help to bolster confidence in what credit unions already know is a sound system.

While any new requirement is viewed with skepticism and as additional paperwork, the acceptance of nonmember accounts is

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not mandatory. Only those credit unions that opt to deal with such accounts would be affected. Many credit unions already utilize CPA audits. Designated low-income credit unions, those that might view the requirement as burdensome since they are more likely to rely on nonmember accounts than do other types of credit unions, will benefit the most. It is their reliance that subjects them to the closest scrutiny. Fiduciaries of public units and charitable or community development groups will have more confidence in providing funds to these credit unions when independent audits are available.

Comments on this proposal must be received on or before February 20, 1989.

## **Regulatory Procedures**

### *Regulatory Flexibility Act*

This interim final rule imposes a limitation on the amount of funds that a federally-insured credit union may accept in the form of public unit and nonmember accounts. However, the rule also provides a method for obtaining an exemption from the limitation upon a showing of need and ability to manage the funds in these accounts. For that reason, the NCUA Board certifies that this interim final rule will not have a significant economic impact on a substantial number of small credit unions. Therefore, a regulatory flexibility analysis is not required pursuant to 5 U.S.C. §605(b).

### *Paperwork Reduction Act*

This interim final rule contains one paperwork requirement: any credit union requesting an exemption from the 20% limitation must submit an explanation of the need to raise the limit and must provide copies of its lending and investment policies. This requirement will be submitted to the Office of Management and Budget for review under the Paperwork Reduction Act. Written comments on this rule should be forwarded directly to the OMB Desk Officer indicated below at the following address: OMB Reports Management Branch, New Executive Office Building, Room 3208, Washington, DC 20530, ATTN: Jerry Waxman.

### *Executive Order 12612*

The NCUA Board has considered the fact that this interim final rule will affect federally-insured state-chartered credit unions (FISCU's) that accept public unit and nonmember accounts. It does not impose any additional costs or burdens

on the states, nor does it affect the states' ability to discharge traditional state government functions. The benefits provided and protection afforded by the NCUSIF is the same for FISCO's as it is for Federal credit unions. It is protection afforded through a Federal system and the responsibility for administering that system lies with the NCUA Board. All federally-insured credit unions, whether Federal or state chartered, will be subject to the same requirement. To the extent that the practices of all credit unions are the same, i.e., acceptance of public unit and nonmember accounts, and have the same effect on their insuring fund, those practices must be subject to the same requirements. The acts and practices subject to this interim final rule have implications for the entire federally-insured credit union system and its insurer and are not unique to only one type of charter.


**List of Subjects in 12 CFR Part 701**

Credit unions, public units, nonmember accounts.

**List of Subjects in 12 CFR Part 741**

Credit unions, public units, nonmember accounts.

By the National Credit Union Administration Board on  
December 14, 1989.

  
BECKY BAKER,  
Secretary of the Board.

Accordingly, NCUA amends its regulations as follows:

**PART 701 -- ORGANIZATION AND OPERATION OF FEDERAL CREDIT  
UNIONS**

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

**Authority:** 12 U.S.C. 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789.

2. By adding a new §701.32 to read as follows:

**§701.32 Payments on shares by public units and nonmembers**

(a) A Federal credit union may, to the extent permitted under Section 107(6) of the Act, receive payments on shares, (regular shares, share certificates, and share draft accounts) from public units and political subdivisions thereof (as those terms are defined in §745.1) and nonmembers, including nonmember credit unions.

(b) Unless a greater amount has been approved by the Regional Director, the maximum amount of all such accounts shall not, at any given time, exceed 20% of the total shares of the Federal credit union. A Federal credit union seeking an exemption from the 20% limit must present, at a minimum, an explanation of the need to raise the limit and copies of its lending and investment policies.

(c) The limitations herein do not apply to accounts maintained in accordance with §§701.37-1 (Treasury Tax and Loan accounts) and 701.37-2 ( Treasury Depository or Financial Agent accounts.)

**PART 741 -- REQUIREMENTS FOR INSURANCE**

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

**Authority:** 12 U.S.C. 1766, 1781, and 1789.

4. By redesignating §§ 741.5 through 741.10 as §§741.6 through 741.11.

5. By adding a new §741.5 to read as follows:

**§741.5 Maximum public unit and nonmember accounts**

Any credit union that is insured, or that makes application for insurance, pursuant to Title II of the Act, must adhere to the requirements of §701.32 regarding public unit and nonmember accounts, provided it has the authority to accept such accounts.