



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

January 22, 1991

A.P. Taylor
Special Administrator
Credit Union Law
State of California
Department of Corporations
3700 Wilshire Boulevard
Los Angeles, CA 90010-3001

RE: Payment of Dividends
(Your Letter of November 27, 1990)

Dear Mr. Taylor:

You have requested assistance with a situation that federally insured state-chartered credit unions ("FISCUs") receiving assistance under Section 208 ("Section 208 assistance") of the Federal Credit Union Act ("FCU Act") are having in California. See 12 U.S.C. §1788. California law does not permit credit unions to declare a dividend if the credit union has a deficit in undivided earnings or if the payment of the dividend would result in a deficit in the undivided earnings account. When the NCUA provides Section 208 assistance, it may take the form of a guarantee of the dividend of the assisted credit union. The payment of a dividend in such a situation, you state, may violate California law. You suggest that the NCUA give instructions to such assisted credit unions to post an entry recording the Section 208 assistance as a receivable in an amount sufficient to clear the undivided earnings deficit and provide sufficient undivided earnings out of which to pay the proposed dividend. It is and remains the position of the NCUA that this method does not comply with full and fair disclosure requirements. We would suggest that your office either interpret or amend the California statute to permit NCUA practice. This memorandum does not address any reserve transfer issues.

FOIA

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FACTS

FISCUs chartered in California may only pay a dividend as provided by the California Credit Union Law. You directed us to Sections 14901 and 14902 of the California Credit Union Law, which reads:

14901. (a) The rates of dividends and terms of payment may be established in advance by action of the board of directors.

(b) Notwithstanding subdivision (a), all dividend rates on any type of share account, whether or not specified or contracted for in advance, shall be accrued as an expense and credited to an allowance for anticipated dividends and reported as such on the credit union's monthly financial statement. However, nothing in this subdivision shall be construed to permit any credit union to pay a dividend except as provided in Section 14902. Cal.Fin.Code §14901. (emphasis added).

14902. The directors of any credit union may, for the dividend period, declare dividends from its undivided profits as provided by law, but no credit union shall credit or pay any dividends or pay loan interest refunds to its members until it has transferred to its regular reserve such part of its gross income as required by Section 14700. However, nothing in this division shall be construed to permit the credit union to credit or pay a dividend from its undivided profits account when the credit or payment would result in a deficit in the undivided profits account. Cal.Fin.Code §14902. (emphasis added).

Among other things, Section 208 of the FCU Act permits the NCUA to provide special assistance to FCUs and FISCUs in or-

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der for the credit union to avoid liquidation while restructuring. 12 U.S.C. §1788. The NCUA Board "is authorized to make loans to, or purchase assets of, or establish accounts in such (assisted) insured credit union upon such terms and conditions as it may prescribe." Id. One of methods that the NCUA may use under Section 208 is the guarantee of dividends by the credit union receiving Section 208 assistance.

ANALYSIS

FISCUs are required "to permit the [NCUA] Board to have access to any information or report with respect to any examination made by or for any public regulatory authority, including any commission, board, or authority having supervision of a State-chartered credit union, and furnish such additional information with respect thereto as the Board may require...." 12 U.S.C. §1781(b)(3). This requirement is memorialized in the Application and Agreement for Insurance of Accounts that the FISCU must enter into in order to have its accounts insured by the National Credit Union Share Insurance Fund ("NCUSIF"). See Application and Agreement for Insurance of Accounts, Section 10 (FISCU "hereby agrees: ...10. To permit the Board to have access to all records and information concerning the affairs of the credit union and to furnish such information pertinent thereto that the Board may require."). This requirement must be read in conjunction with the statute requiring the FISCU "to comply with the requirements of [Title II of the Federal Credit Union Act] and of regulations prescribed by the Board pursuant thereto." 12 U.S.C. §1781(b)(9). This requirement is also memorialized in the Application and Agreement for Insurance of Accounts. See Application and Agreement for Insurance of Accounts, Section 9 (FISCU "hereby agrees: ...9. To comply with the requirements of Title II of the Federal Credit Union Act and of regulations prescribed by the Board pursuant thereto.").

Section 741.9 of the NCUA Rules and Regulations contains the criteria used to determine the insurability of a credit union. This section mandates that "[t]he officers, directors, and committee members of the credit union must have conducted its operations in accordance with provisions of applicable law, regulations, its charter and bylaws, and agree to comply with full and fair disclosure requirements in accordance with Section 116 of the Act and Part 702 of NCUA's

Rules and Regulations." 12 C.F.R. 741.9(c) (emphasis added).
"Full and fair disclosure" is defined in Section 702.3 of the
NCUA Rules and Regulations.

702.3 Full and Fair Disclosure Required.

(a) "Full and fair disclosure" is the level of disclosure which a prudent person would provide to a member of a Federal credit union, the NCUA, or, at the discretion of the board of directors, a creditor in order to fairly inform any or all of them of the financial condition and the results of operations of the credit union.

(b)(1) Federal credit union financial statements shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation allowance accounts as may be necessary to present fairly the financial position; and all income and expenses necessary to present fairly the results of operations for the period concerned.

(2) Full and fair disclosure will further be accomplished by (i) selecting one of the accounting bases provided for in the Accounting Manual for Federal Credit Unions which shall be either the modified cash basis or the accrual basis of accounting, and by (ii) use of appropriate financial statements described in the Accounting Manual for Federal Credit Unions, or financial statements of equivalent format.... 12 C.F.R. §702.3.

-Adherence to Section 2000 of the Accounting Manual for Federal Credit Unions (the "Manual") ensures compliance with the full and fair disclosure requirements of Section 702.3 of the NCUA Rules and Regulations. NCUA Accounting Manual for Federal Credit Unions, §1010.1 (November 1989). Section 2070.1.12, NCUA Insurance Guaranty, of the Manual states:

Any guaranty provided by NCUA to a credit union to make it insurable under Title II of the Federal Credit Union Act, as

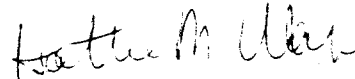
amended, should not be recorded as income. This guaranty represents a claim by the credit union against NCUA which is payable only in the event of liquidation of the credit union and then only to the extent needed to reduce or eliminate loss claims against the Title II share insurance fund. Amortization of guaranties should be through charges to expense in accordance with the terms of the guaranty agreement. NCUA Accounting Manual for Federal Credit Unions, §2070.1.12 (November 1989).

Because of this requirement, a credit union receiving Section 208 assistance may not record a NCUA guarantee as an asset, as you would suggest. This would defeat the purposes of full and fair disclosure and of presenting fairly the financial position of a credit union at a particular date and the results of operations for a particular period in accordance with generally accepted accounting principles and other principles in the Manual. NCUA Accounting Manual for Federal Credit Unions, §2080.1 (November 1989). NCUA requires that the deficit of a Section 208 assisted credit union be transferred to a new capital account called "prior undivided earning deficit -- NCUSIF guaranteed." Section 208 assisted credit unions may then pay dividends from current undivided earnings, if written confirmation is received from NCUA. In fact, the authority to authorize dividend payments, for a maximum of two quarterly dividend periods, for credit unions having deficits in undivided earnings, is delegated to NCUA Regional Directors. Concurrence of the Director, Office of Examination and Insurance, is required for all requests over \$200,000 and is predicated upon receipt of a copy of the credit union's current financial statements and the Regional Director's projected date for NCUA Board action if necessary, or for Section 208 assistance up to \$2 million. See NCUA Delegations of Authority, Supervision 3 (June 1990). According to NCUA's Office of Examination and Insurance, other states permit Section 208 assisted credit unions to pay dividends, if the NCUSIF guarantees the deficit. Therefore, it appears reasonable for the State of California to interpret Section 14902 of the California Credit Union Law to mean "current" undivided earnings or profits in the case of a Section 208 assisted credit union. As you also stated in your

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letter, a legislative change in Section 14902 would also reach the same result. If neither of these alternatives are suitable to you, we may at that time consider whether a pre-emption of Section 14902 is necessary by the NCUA.

Sincerely,



Hattie M. Ulan
Associate General Counsel

cc: Foster C. Bryan
Region VI Director

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