

MEMORANDUM

DATE: December 12, 2012

TO: Senator Kim Koppelman, Chairman
Administrative Rules Committee

FROM: Robert J. Entringer, Commissioner

SUBJECT: Department of Financial Institution – January 2013 rules

In a December 3, 2012, email addressed to the Department of Financial Institutions, Code Reviser John Walstad asked that a representative of the Department appear before your committee to testify on the proposed amendments to Article 13-03 relating to the regulation of credit unions and specifically respond to the following questions.

1. Whether the rules resulted from statutory changes made by the Legislative Assembly.

These rules did not result from any statutory changes made by the Legislative Assembly. These amendments were drafted as a result of matters that came to the Department's attention by way of examination and investigations. The Department also met with trade associations representing state chartered credit unions in order to ensure that industry input was taken into account.

2. Whether the rules are related to any federal statute or regulation. If so, please indicate whether the rules are mandated by federal law or explain any options your agency had in adopting the rules.

While the proposed rules are not drafted based on any federal or state mandates, many of the amendments are drafted in order to create consistency with various federal definitions and requirements.

3. A description of the rulemaking procedure followed in adopting the rules, e.g., the type of public notice given and the extent of public hearings held on the rules.

At its regular meeting held March 16, 2012, the State Credit Union Board completed its first review of the various amendments drafted by Department staff. At that meeting the Board authorized the Department to proceed with hearing, notice, and publication for the rules. Notice was published in every official county newspaper in North Dakota with the final publication occurring no later than May 22, 2012. Notice was also mailed out to all state and nationally-chartered credit unions in North Dakota; National Association of State Credit Union Supervisors (NASCUS); National Credit Union Association (NCUA); North Dakota Bankers Association (NDBA); Independent Community Banks of North Dakota (ICBND); Mid America Credit Union Association; and all State Credit Union Board members. The public hearing on the proposed rule amendments was held at 10:00am on June 20, 2012, in the Office of the Department of Financial Institutions, before Assistant Commissioner Aaron Webb, who acted as the Hearing Officer. The final comment period ended at 5:00pm on July 2, 2012. After the comment period had expired, the State Credit Union Board met again at a July 25, 2012 board meeting. In this meeting, the State Credit Union Board reviewed the comments, and made a series of non-substantive changes to the rule amendments. The rules were sent to the Attorney General's Office for examination as to the legality on July 31, 2012; on August 27, 2012, the Attorney General issued an opinion that the rules, in substantial compliance with N.D.C.C. Ch. 28-32, were approved as to their legality. The rules were adopted in final form at the September 7, 2012, State Credit Union Board meeting and were filed with the Legislative Council on September 12, 2012.

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4. Whether any person has presented a written or oral concern, objection, or complaint for agency consideration with regard to these rules. If so, describe the concern, objection, or complaint and the response of the agency, including any change made in the rules to address the concern, objection, or complaint. Please summarize the comments of any person who offered comments at the public hearings on these rules.

No comments were made at the public hearing concerning the rules. The Department received one written comment regarding the rules; a letter dated June 28, 2012, from Marilyn Foss, General Counsel for the North Dakota Bankers Association. Ms. Foss had various comments concerning the proposed administrative rules. Specifically, she addressed the form of the notice, the lack of standards and processes used when granting exceptions and exemptions under the rules, the fact that some rules did not match the exact language used in the corresponding federal rules, the authority of the Board to expand or grant additional powers to state-chartered credit unions, and delegation of the authority by the Board to the Commissioner.

In response to the comments submitted by Ms. Foss, the state credit union board made various amendments to the proposed rules. First, the board addressed comments relating to the lack of standards and processes applied in the exemption or exception provisions. In reviewing the processes, the board took note that chapter 13-03-01.1 incorporates a set of practices and procedures (found under Article 13-01.1) to be followed when dealing with matters before the credit union board and commissioner. Upon reviewing comments relating to standards, the board modified the amendment to section 13-03-03-01, providing a specific set of criteria the board will review in granting or denying an exemption to the individual investment limitation. However, in reviewing comments submitted in relation to section 13-03-16-02 of the amended rules, the Board determined that criteria were not necessary since the section dealt with internal credit union policies, and not a departmental review of the exception requests.

Secondly, in reviewing comments relating to amended language not matching language found under the corresponding federal rule, the state credit union board reviewed section 13-03-16-05 of the proposed rules. While the Board took note that the language was not an exact match to the federal rule, the board concluded that the difference in language was based on the need for additional clarity, and did not create an inconsistency with the federal rule. Third, upon reviewing Ms. Foss's comments relating to the Board's authority to grant additional powers to credit unions, the board decided to make a variety of changes to its proposed rules. The board removed, within the definition of a "member business loan" under section 13-03-16-01(5), a reference to loans made to other credit unions. Next, the Board removed Farm Credit Services from the definition of "financial organization" under section 13-03-20-01, which would have included them as an eligible organization for purposes of the participation loans. Additionally, the Board reinstated language within section 13-03-21-02 requiring that loans sold to the secondary market must include a substantial portion of loans to the credit union's members. Finally, the board removed from the list of permissible activities under the credit union services chapter, the ability for a CUSO to perform appraisal services, a function not expressly provided for under federal law. Fourth, in reviewing comments relating to the delegation of authority made from the Board to the Commissioner, the Board amended the credit union service organization rule to reinstate the Board reviewed application process currently provided for under the rule.

5. The approximate cost of giving public notice and holding any hearing on the rules and the approximate cost (not including staff time) of developing and adopting the rules.

The cost for publication of the notice was \$1,978.68. The Assistant Commissioner performed the duties of the hearing officer and the hearing was short in duration so the costs were minimal.

6. An explanation of the subject matter of the rules and the reasons for adopting those rules.

Chapter 13-03-01.1 relates to practice and procedure, and is being amended to allow the electronic filing of correspondence to the state credit union board.

Chapter 13-03-02 provides for limits and restrictions associated with loans made by a credit union which are secured by real property. First, this chapter is being altered to remove the reference to corporate central credit unions as there no longer is a corporate central credit union in North Dakota. This chapter is also being amended in order to bring the real estate appraisal requirements in line with federal regulation and FFIEC guidance (to which the credit unions are already subject). Additionally, this chapter is being amended to remove the requirement for fire and tornado insurance policies in an amount equal to the loans. Next, amendments to this chapter include the removal of duplicative language relating to loan limitations and language which is outdated. Finally, as is done in other areas of this bill, the term "total equity capital and reserves" is being replaced with "net worth"; a definitional change that is consistent with other federal regulations.

Chapter 13-03-03 is being modified to include a process whereby the State Credit Union Board may grant an exemption to the individual investment limitation found under section 13-03-03-01. As a result, if the state credit union board, after reviewing the stated criteria, determines that an exemption is warranted, the applying credit union would be authorized to invest amounts in addition to the 10% aggregate limit of the total paid in shares and deposits of the credit union in first lien, public utility, industrial, corporations located in the United States of America. As proposed in the previous chapter, this chapter is being altered to remove the reference to corporate central credit unions.

Chapter 13-03-04 is also being modified to remove the reference to corporate central credit unions.

Chapter 13-03-05 amends the criteria used by the State Credit Union Board in granting an application for merger. First, the amendment creates flexibility for the board in dealing with a merger in the case of a failing institution. Additionally, the amendment specifies that only in a situation where there is a failing institution, will the board consider of similar field of membership and proximity when there are multiple potential merger partners. The reason for this change is the fact that in a regular merger, the credit union's membership has already had the opportunity to assess the qualifications of each potential merger partner. The Board felt that, under normal circumstances, substituting its opinion over the will of the members did not seem warranted.

Chapter 13-03-06 is a chapter pertaining to credit union reserve funds and prompt corrective actions. The amendments proposed by the department create and amend various definitions used in evaluating a credit union's capital reserve funds, including the definition of "net worth", "net worth ratio", "net worth restoration plan", "quarterly reserve requirement", "risk-based net worth requirement", and "total assets". These definitional changes create consistency with federal law, and provide additional clarity for credit unions. This chapter is also being amended in order to properly disclose the general legal authority relied upon for the passage of the rules, and the law implemented relating to various provisions within the chapter.

Chapter 13-03-08 is the section of law relating to the administration of negotiable or transferable instruments of account. A new section is added to this chapter, clarifying the standards that a credit union will be held to relating to the accounting and reporting treatment of credit applications and overdrafts. This section is consistent with the current standards which the department upholds, and is also consistent with federal rules.

Chapter 13-03-15 addresses regulations associated with a credit union's ability to branch. The first change in this area relates to the list of factors that the State Credit Union Board must review in considering a branch application. Currently, when reviewing a branch application the Board must review whether a credit union has expressed opposition to the branch,

whether the area being considered is being satisfactorily served by a currently operating credit union, and whether granting the branch application would have a “negative impact” on another state or federally chartered credit union. The proposed rule change would replace these standards with a “serious injury” test. The reason for this change is that the “serious injury” test is more instructive, and it already used within the banking regulations. In addition to the foregoing amendment, a new section is being added to this chapter which provides for prior notice to the Department and the membership whenever a credit union intends on closing a branch.

Chapter 13-03-16 provides for member business loan limits. The first proposed change relates to the definition of “member business loans”, and provides that these types of loans include participation loan interests and unfunded loan commitments. The definition of “net worth” is also amended in order to provide additional clarity. Both of the previously referenced modifications provide consistency with the federal rules. Under the Requirements section of this chapter, various amendments are being proposed in the area of internal credit union loan policies relating to limitations on loan-to-value and limitations on the aggregate total value of unsecured member business loans. These policy requirements are designed to better outline expectations and are again consistent with federal requirements. Next, the Loan limit section is being amended in order to incorporate the new definition of “net worth” and to remove a monitoring requirement that is duplicative (the reporting of information that is already captured under the call reporting process). The Allowance for loan loss section of the chapter is being updated to remove duplicative language (already addressed under section 13-03-06) and to create consistency with industry standards and guidance. The Construction and development lending section of the chapter is being amended in order to be consistent with the federal law relating to the calculation of the maximum value of a credit union’s construction and development lending portfolio and the minimum amount of equity interest required to be maintained by a borrower. The prohibitions section of the chapter is modified, consistent with federal law, to make it a violation of state law for a credit union to make member business loans to a compensated director unless the board of directors

approves granting the loan and the compensated director is recused from the decision making process. Finally, the aggregate loan limit section of this chapter is altered to remove language now covered under the definition of a member business loan, and to make the reader aware of a waiver process found under section 13-03-16-09.

Chapter 13-03-20 deals with the regulation of participation loans. This chapter is being amended in order to allow a credit union's board of directors to delegate, by policy, authority for a loan committee to enter into a written master participation agreement on behalf of the credit union. Further, the amendment provides that if the credit union is not the originating lender, it may obtain, as an alternative to the approval of the board of directors, the approval of the loan committee or credit manager to release disbursement of proceeds to the originating lender.

Chapter 13-03-21 provides rules associated with the purchase, sale, and pledge of eligible obligations. The first amendment updates the rule to provide for current secondary market practices. Today most real estate loans are not held and pooled, but instead sold to the secondary market on an individual loan basis. The remaining amendments to the chapter address the internal decision-making authority relating to the purchase, sale, and pledge of eligible obligations. As amended, the credit union's loan committee and credit manager would be able to make decisions relating to these activities, as long as, the credit union board of directors delegates this authority within their written policies.

Chapter 13-03-23 deals with the regulation of a credit union's involvement with credit union service organizations. The first proposed change to this section would replace the definition of "equity" with "net worth", a definition that is used in setting the investment limitations and lending limitations. Secondly, the chapter is being amended to ensure that the application process is broad enough to include activities relating to the establishment, investment, and increase of investments in a credit union service organization. Additionally, the application process will now allow the commissioner the opportunity to deem the application complete prior to

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submitting it to the state credit union board. Thirdly, the chapter is being amended in order to update the permissible services and activities section. While the amended list of permissible services and activities are similar to what is currently provided for under the rule, the change would provide a more organized listing and also provide consistency with the outline of activities found under federal law. The amendment maintains the ability for the state credit union board to authorize, by order, any additional service or activity not included within the list. Prior to a credit union service organization modifying the scope of their activities, the credit union will be required to provide the commissioner with notice of the change. A new section is being proposed that would allow the commissioner or board to limit any credit union service organization activities necessary based on supervisory, legal, or safety and soundness reasons. The final amendment to this chapter requires that every credit union with dealings with a credit union service organization have a written agreement in place (including specific provisions) in order to ensure that the credit union's investment remains in compliance with the rule.

7. Whether a regulatory analysis was required by North Dakota Century Code (NDCC) Section 28-32-08 and whether that regulatory analysis was issued.

A regulatory analysis was not required nor issued.

8. Whether a regulatory analysis or economic impact statement of impact on small entities was required by NDCC Section 28-32-08.1 and whether that regulatory analysis or impact statement was issued.

The Department completed a small entity regulatory analysis and a small entity economic impact statement. Both documents indicate that the financial and regulatory impact of these proposed rule amendments will be minimal in nature. As a result of these proposed changes, credit unions will be provided with additional flexibility in operations.

9. Whether these rules have a fiscal effect on state revenues and expenditures, including any effect on funds controlled by your agency.

A fiscal note was not deemed to be required because these rules have no fiscal effect on state revenues or expenditures.

10. Whether a constitutional takings assessment was prepared as required by NDCC Section 28-32-09.

No constitutional takings assessment was required.

11. If these rules were adopted as an emergency (interim final) rules under North Dakota Century Code Section 28-32-03, provide the statutory grounds from that section for declaring the rules to be an emergency and the facts that support the declaration and provide a copy of the Governor's approval of the emergency status of the rules.

The rules were not adopted as an emergency rule.

SMALL ENTITY REGULATORY ANALYSIS

1. Was establishment of less stringent compliance or reporting requirements for small entities considered? To what result?

No. The majority of the changes made within the proposed rules create additional flexibility to credit unions. Any compliance or reporting requirements included within the proposed rules will have a minimal effect on small entities.

2. Was establishment of less stringent schedules or deadlines for compliance or reporting requirements considered for small entities? To what result?

No. Again, the majority of the changes made within the proposed rules create additional flexibility to credit unions and the remaining changes proposed would have minimal impact on small entities.

3. Was consolidation or simplification of compliance or reporting requirements for small entities considered? To what result?

No. Because the proposed rule amendments create additional flexibility to credit unions, and clarify various regulatory requirements, additional consolidation and simplification was not deemed necessary.

4. Were performance standards established for small entities for replacement design or operational standards required in the proposed rule? To what extent?

No. The rules do not include performance standards for replacement design or operational standards.

5. Was exemption of small entities from all or any part of the requirements in the proposed rule considered? To what extent?

No. In most cases, exempting small entities would place them at a potential disadvantage by not allowing them to participate in changes that would be to their benefit. Additionally, the Department feels that the remaining rules, for which amendments are proposed, should apply consistently to all regulated entities.

SMALL ENTITY ECONOMIC IMPACT STATEMENT

1. Which small entities are subject to the proposed rule?

Any North Dakota licensed Credit Union.
2. What are the administrative and other costs required for compliance with the proposed rule?

The proposed rule amendments will have little to no costs associated with them.
3. What is the probable cost and benefit to private persons and consumers who are affected by the proposed rule?

There are no anticipated costs or direct affects anticipated relating to private persons or consumers.
4. What is the probable effect of the proposed rule on state revenues?

There is no anticipated effect on state revenues.
5. Is there any less intrusive or less costly alternative methods of achieving the purpose of the proposed rule?

No; the proposed changes will have minimal cost and in most cases provide credit unions with additional flexibility.