

Regulatory Compliance

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Volume XI, Number 8

August 2008

Worth Noting

Mortgages. In July, the Federal Reserve Board issued a final rule to strengthen consumer protections in the home mortgage arena. The final rule adds four new protections for a new category of “higher priced mortgage loans.” It also provides three new protections for all home mortgage loans, as well as creating new advertising requirements for mortgage lending. Most of the rule becomes effective October 1, 2009. (One escrow-related provision kicks in one year later.) Next month’s Regulatory Compliance Newsletter will focus on these new requirements. NAFCU is also preparing a Regulatory Alert.

NCUA. Chairman JoAnn Johnson will chair her final NCUA Board meeting in July. The Board plans to issue a final IRPS concerning prohibitions found in § 205(d) of the Federal Credit Union Act. In addition, the Board will issue a proposal that would amend the definition of post-merger net worth. A new NCUA chairman, Michael E. Fryzel, will begin his term at NCUA in July.

Share Insurance. The failure of IndyMac has caused credit union members to examine federal credit union insurance. With that in mind, we have devoted this issue to share insurance compliance matters.

A Look at Share Insurance

Share insurance often goes unnoticed. Members have little reason to think about it, unless something brings the issue to the forefront. The IndyMac situation has done just that, and members have been calling credit unions asking about credit union share insurance protection. This article will provide a basic overview of the share insurance system.

The NCUSIF. Every federally insured credit union must deposit and maintain one percent of its insured shares and deposits in the National Credit Union Share Insurance Fund (NCUSIF). NCUA manages the NCUSIF, which has roughly \$7.65 billion in assets. If the fund grows above a certain equity level, credit unions are paid a dividend. If the fund drops too far, NCUA will assess a premium to bring the NCUSIF back to an acceptable level. In July, NCUA Chairman JoAnn Johnson indicated that the NCUSIF equity ratio likely will increase from the June 30 ratio of 1.24 to a year-end ratio of 1.28. While Chairman Johnson indicated that individual credit unions may have problems, the NCUSIF is strong and credit unions in general are healthy.

How the system works. As the signs in your teller line indicate, NCUA insures shares in a member account (and some nonmember accounts) up to \$100,000. Certain retirement accounts enjoy up to \$250,000 of protection. While the sign notes that members enjoy up to \$100,000 in coverage, many members enjoy much more. Different types of accounts within a credit union are insured separately. If a member has shares in more than one such type, he or she may have more than \$100,000 in share insurance.

Individual Accounts. Individual share accounts owned by the same member are insured up to \$100,000. If a member has one or 20 individually owned share accounts, the maximum share insurance is still \$100,000. See Your Insured Funds, Q and A #11. Also, see 12 C.F.R. § 745.3. Note that commercial accounts may qualify for NCUSIF protection, assuming the business engages in independent activity and was not established only to increase NCUSIF protection. 12 C.F.R. § 745.6.

Joint Accounts. Joint accounts are insured separately from individual accounts. A consumer’s interest in joint accounts is insured up to \$100,000. Unless the account agreement indicates otherwise, a person’s interest in the account is determined by dividing the total amount of shares by the number of joint owners. If a person has an interest in more than one joint account, his or her interest in all such joint accounts is aggregated and insured up to \$100,000. Members cannot increase their joint account insurance coverage by rearranging the names of the owners in different joint accounts. See 12 C.F.R. § 745.8.

Revocable Trust Accounts. This category includes a testamentary account, tentative or “Totten” trust account, “payable-on-death” account, or any similar account that shows an intention for funds to pass on the death of the owner of the funds to a named beneficiary. Such accounts are insured up to \$100,000 for each qualifying beneficiary of an account owner. “Qualified beneficiaries” include a spouse, child, grandchild, parent, or sibling. If a member has such an account with five different children named as beneficiaries, he or she would have

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Compliance Forum

Compliance Forum consists of questions fielded by our Regulatory Compliance Division. In responding to these inquiries, we try to provide our members with information that will assist them with various compliance problems or issues they encounter. NAFCU's Compliance Forum is offered for general informational purposes only and is not intended to serve as legal advice or the legal opinion of NAFCU. NAFCU strongly recommends that each member presented with a compliance issue consult with its own legal counsel and/or outside legal counsel experienced in compliance matters before proceeding.

Question: *We have a few joint revocable trust accounts where a husband and wife have named themselves as the sole beneficiaries. How is this account handled for share insurance purposes?*

Answer: This account would be insured as if it were a joint account. Part § 745.4 indicates that: “[w]here a husband and a wife establish a revocable trust account naming themselves as the sole beneficiaries, the account will not be insured according to the provisions of this section, but will instead be insured in accordance with the joint account provisions of § 745.8.” 12 C.F.R. § 745.4(f). The logic behind this is sound. NCUA insures joint accounts differently from revocable trust accounts. And joint accounts are insured separately from individual accounts and revocable trust accounts. Thus, subsection (f) of Part § 745.4 limits the ability of a husband and wife to create what, in essence, is a second joint account in an attempt to increase share insurance coverage. The husband and wife would both be qualifying beneficiaries of each other if the joint revocable trust account were granted insurance under the revocable trust section, giving the account \$200,000 worth of coverage. However, the limitation in subsection (f) states that accounts set up in this manner should be insured as if they were joint accounts. Further, the joint accounts section includes an aggregation provision: “[t]he interest of a co-owner in all qualifying joint accounts shall be added together and the total for that co-owner shall be insured up to the SMSIA.” 12 C.F.R. § 745.8(a). Therefore, if the husband and wife already had a joint account and were receiving up to \$200,000 in insurance coverage for that account – their joint revocable trust account would not be insured because it is treated as a joint account and aggregated with the other joint accounts of the owners.

Question: *A member has requested that we set up his account to be “payable-on-death” to his trust account. The trust account lists the beneficiaries as the member’s three children. We thought the account would receive up to \$300,000 because the trust is payable to qualifying beneficiaries. Is this correct?*

Answer: No. The account will be insured as if it were an individual account of the member. Thus, it would only receive up to \$100,000 in insurance coverage and will also be added together with any other individual accounts the member has at the credit union. Thus, if the member also has a \$100,000 share certificate, this “payable-on-death” account would be uninsured.

While this may seem harsh, the rationale is that the trust is not a qualifying beneficiary under the share insurance regulations. See 12 C.F.R. § 745.4(b) (indicating that qualifying beneficiaries are a spouse, child, grandchild, parent, brother or sister of the account owner). Since the trust is not a qualifying beneficiary it “shall be treated as an individually owned account of the owner, aggregated with any other individually owned accounts of the owner, and insured up to the SMSIA (\$100,000).” 12 CFR

745.4(c). In this case, the fact that the beneficiaries of the trust are the member’s children is irrelevant for share insurance purposes. Alternatively, if the member were to establish a “payable-on-death” account naming the three children as the beneficiaries they would be qualifying beneficiaries and the account would be insured for up to \$300,000.

Question: *We noticed that we have some members who have shares on deposit which are not fully covered by NCUA share insurance. Could we be held liable for not notifying them of this lack in insurance coverage?*

Answer: No, the credit union does not have a duty to inform individual members of any lack of insurance coverage. However, the credit union must provide general notice to its members regarding insurance coverage of accounts. This can be accomplished by placing copies of Part 745 of NCUA’s rules or copies of the NCUA brochure “Your Insured Funds” in each branch office and main office of the credit union. See 12 C.F.R. § 745.13. Furthermore, the credit union may want to consider proactively consulting members who could improve their share insurance coverage. It could be a good strategy for improving member satisfaction and managing reputation risk.

Question: *We have a question about share insurance coverage of sub-share accounts. For instance, a member could have a main individual membership account with a share, share draft and share certificate account as sub-shares. If the share draft account has a joint owner, would it be insured separately as a joint account?*

Answer: Yes, the joint account will be insured separately from the other individual accounts, even though structured as a “sub-account” under an individual membership account. The share insurance rule defines an account, in part, to mean “share, share certificate, or share draft accounts...” 12 C.F.R. § 745.1(a). The rule further states that “(i)n general, all types of member share accounts received by the credit union in its usual course of business, including regular shares, share certificates, and share draft accounts, represent equity and are insured.” 12 C.F.R. § 745.0. The ownership status of the sub accounts will determine share insurance coverage. See, NCUA Legal Opinion Letter 97-0139 (March 7, 1997).

Question: *We have a nonmember credit union with a share account at our credit union. Is this account covered by share insurance?*

Answer: Yes. NCUA’s share insurance regulations include share insurance coverage for “those nonmembers permitted under the Act to maintain accounts in an insured credit union, including nonmember credit unions and nonmember public units and political subdivisions.” 12 C.F.R. § 745.1(b). In an opinion letter, NCUA opined that such accounts, if properly maintained, are insured by the National Credit Union Insurance Fund (“NCUSIF”) up to the \$100,000 limit, just like an individual member account. NCUA Opinion Letter, 91-0721, August 1, 1991.

Question: *We have retired members who have opened small businesses to help supplement their retirement income. Would business accounts have insurance protection?*

Answer: Yes, if the business qualifies as a member, it would receive insurance pursuant to the NCUSIF. See 12 C.F.R. § 745.1. NCUA cautions, however, that business accounts are covered by share insurance as long as the business is engaged in an independent activity and has not been established for the purposes of increasing insurance coverage. If the business is not engaged in an independent activity, then the account held by the business would be treated as held by the business owner and would be aggregated with his or her other individual accounts for insurance purposes. Although the National Credit Union Administration's (NCUA) rules and regulations do not specifically address business accounts, the Appendix to Part 745 sets forth how accounts held by a corporation, partnership or an unincorporated association are insured. "All funds invested in an account or accounts by a corporation, a partnership or an unincorporated association engaged in any independent activity are added together and insured to the \$100,000 maximum. The term "independent activity" means any activity other than the one directed solely at increasing coverage. If the corporation, partnership or unincorporated association is not engaged in an independent activity, any account held by the entity is insured as if owned by the persons owning or comprising the entity, and the imputed interest of each such person is added for insurance purposes to any individual account which he maintains." Appendix to Part 745, Section D, page 745-9.

Question: *Our credit union has a question regarding share insurance coverage. A member has one account that is payable on death (POD) to his four children. For how much insurance is the account eligible? The member has no other accounts with us.*

Answer: According to NCUA, a revocable trust account (i.e. a POD account) is insured up to \$100,000 for each beneficiary if the named beneficiary is a spouse, child, grandchild, parent, brother or sister. 12 C.F.R. § 745.4. Therefore, in your example, the account would be insured up to \$400,000. Printed in June 2002 Regulatory Compliance Newsletter

Question: *The following accounts are held by members A, B and C, each of whom has personally executed signature cards for the accounts in which he has an interest. Each co-owner of a joint account possesses the necessary withdrawal rights.*

1. A, as an individual—\$100,000.
2. B, as an individual—\$100,000.
3. C, as an individual—\$100,000.
4. A and B, as joint tenants w/r/o survivorship—\$90,000.
5. A and C, as joint tenants w/r/o survivorship—\$90,000.
6. B and C, as joint tenants w/r/o survivorship—\$90,000.
7. A, B and C, as joint tenants w/r/o survivorship—\$90,000. What is the insurance coverage?

Answer: Accounts numbered 1, 2 and 3 are each separately insured for \$100,000 as individual accounts held by A, B and C, respectively (§ 745.3(a)(1)). The interest of the co-owners of each joint account are deemed equal for insurance purposes (§ 745.2(c)(4)). A's interest in accounts numbered 4, 5, and 7 are added together for insurance purposes (§ 745.8(e)). Thus, A has an interest of \$45,000 in account No. 4, \$45,000 in account No. 5 and \$30,000 in account No. 7, for a total joint account interest of

\$120,000, of which \$100,000 is insured. The interests of B and C are similarly insured.

Question: *Member H invests \$100,000 in each of four "payable-on-death" accounts. Under the terms of each account contract, H has the right to withdraw any or all of the funds in the account at any time. Any funds remaining in the account at the time of H's death are to be paid to a named beneficiary. The respective beneficiaries of the four accounts are H's wife, his mother, his brother, and his nephew. H also holds an individual account containing \$100,000. What is the insurance coverage?*

Answer: The accounts payable on death to H's wife, mother and brother are each separately insured to the \$100,000 maximum (Sec. 745.4(b)). The account payable to H's nephew is added to H's individual account and insured to \$100,000 in the aggregate, leaving \$100,000 uninsured (Sec. 745.4(c)).

Editor's note: the previous two questions were taken from Appendix A to Part 745 of NCUA's rules and regulations. The Appendix contains many other useful examples.

Question: *Numerous individual chapters of a national organization have set up their own accounts at our credit union. Is each account eligible for up to \$100,000 in share insurance, or are all the accounts aggregated and limited to \$100,000?*

Answer: The answer depends on who ultimately owns the accounts. If the individual chapter is engaged in an independent activity and the accounts are legally owned by the chapters, each account is likely insurable to \$100,000. Paragraph D of the Appendix to Part 745 of NCUA Rules and Regulations provides additional guidance through the use of several examples. Printed in February 2005 Regulatory Compliance Newsletter

Question: *Our credit union has the county school system within our field of membership. Several of the individual schools have set up accounts with the credit union. Are these accounts insured separately up to \$100,000 by the NCUSIF or must the funds be aggregated for a maximum of \$100,000 in coverage?*

Answer: The accounts will be insured separately as long as the official custodian of the funds in each account is different. For the purpose of determining the amount of insurance coverage for public unit accounts, the funds are viewed as belonging to the designated custodian rather than belonging to the account itself. All funds belonging to the same custodian must be aggregated and are insured to a maximum of \$100,000. However, if the accounts have different custodians, the accounts would be insured separately to a maximum of \$100,000. 12 C.F.R. § 745.10 (a)(2).

Question: *May our credit union deposit funds with another federal credit union?*

Answer: Yes. Under the Federal Credit Union Act, a federal credit union may receive payments (deposits) on shares, share certificates and share draft accounts from other credit unions. 12 U.S.C. § 1757(6). Such deposits are insured pursuant to 12 U.S.C. § 1781(a) and in accordance with 12 U.S.C. § 1787(H) and NCUA Rule 745. NCUA Legal Opinion Letter 96-0808 (August 16, 1996). Printed on February 2001 Regulatory Compliance Newsletter

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\$500,000 of share insurance coverage. A member may not increase the insurance coverage by naming the same beneficiary in more than one revocable trust account; the beneficiary's interest in all such accounts owned by that member would be aggregated and insured up to \$100,000. For these accounts to gain revocable trust status, NCUA requires that the account records reflect the owner's intent to pass funds upon their death to a named beneficiary. NCUA strongly suggests that account titles reflect the revocable trust/POD status. NCUA Legal Opinion Letter 03-0413 (May 20, 2003). For joint revocable trust accounts, the respective interests of each owner held for the benefit of each qualifying beneficiary would be insured up to \$100,000. Note that joint and individually-owned revocable trust accounts are not insured separately. Rather, \$100,000 of NCUSIF protection covers each qualifying beneficiary of a revocable trust account owner in all such accounts (individual or joint) at the credit union. The interest of each beneficiary will be deemed equal unless otherwise stated in the share account record. For revocable trusts, interests held for non-qualifying beneficiaries will be added to the individual accounts of the owners for NCUSIF purposes. See 12 C.F.R. § 745.4.

Irrevocable Trust Accounts. For these accounts, all trust interests for a beneficiary of the same grantor (regardless of relation) are aggregated and insured up to \$100,000. See 12 C.F.R. § 745.9-1.

Nonmember Accounts. Nonmember joint owners on credit union accounts benefit from share insurance. 12 C.F.R. § 745.8(d). Nonmember accounts opened by other credit unions, public units and other nonmembers where permitted under the Federal Credit Union Act also qualify for NCUSIF protection. See 12 C.F.R. §§ 745.1, 745.10.

Retirement and Employee Benefit Plan Accounts. IRAs and Keogh accounts are separately insured to \$250,000. Roth and Traditional IRAs are aggregated and insured up to \$250,000 while Keogh accounts are separately insured from IRA accounts. 12 C.F.R. § 745.9-2. Employee benefit accounts are insured separately from Keogh and IRA accounts and are insured up to \$100,000 for each participant's interest in the account. Id.

Notification. Insured credit unions must provide notice to members regarding NCUSIF protection. This can be accomplished by placing a copy of Part 745 of NCUA's regulations, the regulation's appendix or a copy of the NCUA brochure "Your Insured Funds" in each branch office and main office of the credit union. Credit unions must make such materials available to members upon request. 12 C.F.R. § 745.13. While not required, credit unions, in order to manage reputation risk and educate members, may wish to consider issuing statement inserts and placing information on their websites to address NCUSIF protection.

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