

May 10, 2011

Corporate Credit Union Follow-up Rule

EXECUTIVE SUMMARY

- The National Credit Union Administration (NCUA) has adopted a final rule to amend its corporate credit union rule, contained in Part 704, which was issued as a proposal in November 2010. The final rule:
 - Permits corporate credit unions to charge their members reasonable one-time or periodic membership fees;
 - Requires corporates to maintain a record of all board of director votes, including which if any directors voted "no" or abstained from voting;
 - Incorporates certain audit, reporting, and supervisory committee practices from existing non-credit union guidance, such as the Federal Deposit Insurance Corporation (FDIC) regulations;
 - Requires corporates to establish enterprise-wide risk management committees staffed with at least one independent risk management expert; and
 - Requires the disclosure of certain compensation paid by a corporate credit union service organization (CUSO) to highly compensated corporate credit union executives.
- The final rule does not include two proposed provisions that CUNA strongly opposed, which would have:
 - o Limited natural person credit unions to membership in only one corporate at any one time; and
 - Required all users of corporates, including non-federally insured credit unions (FICUs), to share in the expenses associated with the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund).
- The final rule is generally effective May 31, 2011. However, various provisions of the section on audit and reporting are effective between January 1, 2012 and January 1, 2014. In addition, the new section on enterprise risk management is effective April 29, 2013.

BRIEF DESCRIPTION OF THE FINAL RULE

Of the seven main provisions included in the November proposed rule, two were adopted as proposed, three adopted in a modified form, and two were excluded from the final rule. In our comment letter to NCUA, CUNA strongly opposed the two proposed provisions that are absent from the final rule; these would have: (1) limited natural person credit unions to membership in only one corporate at any one time; and (2) provided for the equitable sharing of future Stabilization Fund expenses among all members of corporates, which would have included all FICUs as well as non-FICUs. The remaining five provisions that are adopted in the final rule are described below.

Membership Fees - § 704.22 (unchanged from proposal)

The rule establishes a new section on membership fees that permits a corporate credit union to charge its members a one-time or periodic fee as a condition of membership. The fee must be uniform and proportional to the member's asset size. The corporate may reduce the fee for members that have contributed capital to the corporate, but any reduction needs to be proportional to the amount of the member's non-depleted contributed capital.

A corporate must provide its members with at least six months notice of a new fee or a material change to a recurring fee. If a member fails to pay the fee within 60 days of being invoiced, the corporate has the option to of terminating its membership.

The new section on membership fees is effective May 31, 2011.

<u>Disclosure of CUSO-related Compensation</u> – §§ 704.11; 704.19 (unchanged from proposal)

Under the rule, a corporate credit union's annual disclosures of compensation paid to its most highly compensated employees under § 704.19 must include any compensation paid to these employees by a corporate CUSO in which the corporate has invested or made a loan.

To facilitate the disclosure of compensation paid by a corporate CUSO, the rule amends § 704.11 to require a corporate that wishes to use a CUSO to first obtain written agreement that the CUSO will:

- Allow the auditor, board of directors, and NCUA complete access to the CUSO's personnel, facilities, equipment, books, records, and any other documentation deemed pertinent; and
- Disclose to the corporate at least quarterly the compensation to the CUSOs employees who are also employees of the corporate.

NCUA stated in the supplementary information to the final rule that the Board currently has no intention of imposing these disclosure requirements on natural person credit unions and their CUSOs. However, CUNA remains concerned that this is a possibility and continues to oppose increased disclosure and reporting requirements as part of CUNA's overall efforts to reduce the regulatory burden on credit unions.

The provision on disclosure of CUSO-related compensation is effective May 31, 2011.

Board Responsibilities – § 704.13 (modified from proposal)

The proposed rule would have required a corporate to record all board of director votes and include the votes of individual directors in the meeting minutes.

The final rule is modified slightly from the proposal to require recording only "no" votes and abstentions on all board votes, as long as the names of directors attending the meeting are recorded elsewhere in the minutes.

The provision on board responsibilities is effective May 31, 2011.

Audit and Reporting Requirements - § 704.15 (modified from proposal)

The rule adds certain auditing, reporting, and supervisory committee requirements, the most significant of which are described below. The requirements are very similar to those required of banks by FDIC.

Under the final rule, a corporate credit union is required to ensure that its financial reports reflect all material correcting adjustments necessary to conform with generally accepted accounting principles (GAAP) as identified by the corporate's independent public accountant (IPA).

The corporate must also prepare an annual management report, signed by its CEO and chief accounting officer or chief financial officer, that contains:

- A statement of management's responsibility for: preparing financial statements, establishing and maintaining an adequate internal control structure, and complying with safety and soundness laws and regulations.
- An assessment of the corporate's compliance with such laws and regulations.
- An assessment of the effectiveness of the internal control structure (the proposal would have limited this
 assessment to only corporates with at least \$1 billion in assets). The assessment requirement is
 effective January 1, 2013.

In addition, the corporate must ensure that it's IPA:

- Reports to the supervisory committee all critical accounting policies;
- Retains the working papers related to an audit for seven years;
- Complies with the independence standards and interpretations of the American Institute of Certified Public Accountants;
- Has an acceptable peer review;
- Notifies NCUA if the IPA ceases being the corporate's independent accountant; and

Reports separately to the supervisory committee on management's assertions concerning the
effectiveness of the corporate's internal control structure (the proposal would have limited this
assessment to only corporates with at least \$1 billion in assets). The assessment requirement is
effective January 1, 2014.

Under the final rule, a corporate credit union will need to ensure that it:

- Files a copy of its annual report to NCUA within 180 days after the end of the calendar year, which NCUA will make available for public inspection:
- Provides NCUA with a copy of any letter or report issued by its IPA;
- Informs NCUA when it changes its IPA:
- Provides a notice to NCUA of late filing of the annual report; and
- Submits a summary of its annual report to the membership.

Lastly, the rule requires a corporate to ensure that its supervisory committee (1) consists of members who are independent of the "operational side" of the corporate, (2) supervises the IPA, and (3) ensures that audit engagement letters do not contain unsafe and unsound limitation of liability provisions. The final rule clarifies that an independent member is someone who does not have any familial or material business relationships with the corporate's CEO or anyone supervised by the CEO.

The section on the audit and reporting requirements is generally effective January 1, 2012, except the delayed effective dates for the provisions as noted above.

Enterprise Risk Management – § 704.21 (modified from proposal)

The final rule adopts the proposed rule on enterprise risk management (ERM) with minor modifications. Under the rule, a corporate must develop and follow an ERM policy and the board of directors must establish an ERM committee responsible for reviewing the corporate's ERM practices. The ERM committee must report at least quarterly—increased from annually in the proposal—to the board.

The final rule clarifies that the ERM committee's mission is to review and report on management's identification and management of all of the corporate's significant and emerging enterprise risk. The ERM committee will act in an advisory capacity to the board of directors to ensure that the board obtains focused, comprehensive information on enterprise risk, and not just on the individual, specific risks addressed by the ALCO, credit, and supervisory committees. The ERM committee will address all of an enterprise's risks—including financial, operational, strategic, compliance, and reputational risks—under one umbrella.

The ERM committee must include at least one independent risk management expert with sufficient experience in identifying, assessing, and managing risk exposures. In addition, the expert needs to have post-graduate education; an actuarial, accounting, economics, financial, or legal background; and at least five years' experience in identifying, assessing, and managing risk exposures. To address questions raised by CUNA and others regarding the independence of an expert, the final rule clarifies that an expert will qualify as independent if:

- The expert reports to the ERM committee and to the corporate's board;
- Neither the expert, nor any immediate family member of the expert, is supervised by or has any material business relationship with the corporate's CEO, or anyone supervised by the CEO; and
- Neither the expert, nor any immediate family member of the expert, has had any such relationships for at least the past three years.

The new section on enterprise risk management is effective April 29, 2013.

For questions regarding the rule, please contact Senior Vice President and Deputy General Counsel Mary Dunn / (800) 356-9655 ext. 6736, or Assistant General Counsel Luke Martone / ext. 6743.

<u>Click here</u> for the final rule.