

STATEMENT OF NEED AND REASONABLENESS
OF AMENDMENTS TO RULES GOVERNING CREDIT UNIONS

November 26, 1984

The Minnesota Code of Agency Rules concerning the operation of credit unions are being modified, deleted and promulgated to facilitate changes in the industry.

BOOKS, RECORDS, AND REPORTS

Recordkeeping services has been changed to data processing off premises to more clearly identify the subject of the rule. The rule which requires another credit union or service corporation to issue a certificate stating its agreement to perform the services in compliance with statute and acknowledging that its services are subject to the same regulation and examination as the contractee has been simplified through language changes.

DAILY CLOSING

Added to Rule 135 Books, Records and Report is a section which requires credit unions that maintain in excess of \$500,000 in accounts subject to draft withdrawal to post all assets and liabilities on a daily basis. Credit unions now prepare a monthly financial statement which is required by the standard bylaws to be posted in a conspicuous place in the credit union office by the 10th of

the following month. Many credit unions are unable to prepare the monthly statement within 10 days of the following month due to a delay in obtaining data from the data processing servicer.

Accumulation of data until month end has caused difficulty in reconciling accounts, planning cash flow, general management of the credit unions affairs and violation of credit unions bylaws when preparation of the monthly statement is delayed beyond the prescribed period of time. Large credit unions and credit unions with sharedrafts are especially vulnerable from the failure to prepare a daily statement of the credit union's assets and liabilities. Compounding of differences in accounts from failure to reconcile accounts on a daily basis has contributed to the need for supervisory action to restore financial integrity in several credit unions. Daily closing and reconciliation would have prevented this problem.

On-line data processing and an integrated general ledger package is available and used by some credit unions. Due to the need and the availability it is reasonable to require the daily posting of accounts.

STATEMENT OF ACCOUNTS

The section of the rules dealing with statement of accounts have been modified to include three changes. The first change requires a statement of account to be issued at least monthly on sharedraft accounts. The purpose of this is to assist the member draft account holder in reconciling his account position with that of the credit union so that any discrepancies can be promptly corrected.

Statements on other types of accounts which were required to be issued quarterly have been changed to coincide with the dividend period. The Rule now provides that statements must be issued at least annually but need not be issued more often than quarterly. This is a cost saving consideration for smaller credit unions who normally pay an annual dividend.

For expense reduction and audit control, special treatment has been given to those accounts which the board has determined to be inactive. These accounts may be segregated and issued a statement annually under the control of the supervisory committee.

Where passbooks are issued in place of account statements the rule has been modified to require an annual notification to members to have their passbooks brought into the credit union office for current posting.

PURCHASE OF REAL ESTATE

The rule prohibiting the purchase of real estate without prior approval of the Commissioner has been modified to provide greater flexibility. Under the modification, a credit union may purchase real estate for credit union premises. In recognition of the need to limit investments in fixed assets to maintain safety and soundness, credit unions are required to obtain prior approval from the Commissioner when an investment in credit union premises or leasehold investments will exceed 50 percent of total reserves. A disproportionate asset investment in fixed assets will have an adverse affect on earnings and must therefore be controlled. At the same time, credit unions should have the

flexibility to make decisions on investments in fixed assets where safety and soundness is maintained. Fifty percent of reserves is a benchmark found in the banking industry. Most credit unions have investments in credit union premises at levels significantly less than 50% of their total reserves.

OTHER REAL ESTATE

This section of the rules has been rewritten for better understanding and to authorize the financing of the sale of other real estate as owned real estate. This authorizes a loan to a non-member where the loan is to purchase property owned by the credit union.

REAL ESTATE MORTGAGES

Authorization is provided for equity lending taking real estate as security as long as the total of the liens outstanding do not exceed 80% of the property appraised value. The authorization is in response to the demand from members for this type of loan while maintaining restrictions required for safety and soundness.

Additionally, the section dealing with document requirements has been rewritten for better understanding and to provide greater flexibility while retaining the necessary requirements for safety and soundness.

The rules permit the board of directors to establish fees in connection with real estate loans and require that the member be presented with a estimate of those fees at the time of application as well as the refundable portion in case the loan is not approved. This provides flexibility in the management of the credit union's loans as well as providing disclosure for the benefit of the member.

The board may exclude certain loans from the classification of real estate loans as provided in the provisions of the rules titled exempt loans. This is an expense consideration and again provides flexibility in the management of the loan portfolio.

PERSONAL LOANS

Accounting for premiums paid by the credit union to provide insurance coverage on items taken as security has been included in the rules. This is necessary to accurately assess the asset condition of the credit union. Adding such premiums to loan balances led to inaccurate delinquent loan computation and increased the booked asset value of low quality loans.

The rule requiring financial statements to support unsecured advances in excess of a stated amount has been modified to provide for an increase in the stated amount for those credit unions whose assets exceed \$10,000,000. These larger credit unions can absorb more risk and the change is consistent with their policies.

DELINQUENT LOANS

Several changes have been made in the delinquent loan section of the rules for consistency, better understanding and safety and soundness. The required scheduling of delinquent loans has been modified to provide consistency in interpretation and to require scheduling consistent with that used by the National Credit Union Administration, the insuring agency.

Rules in regard to extensions and reporting of delinquent loans have been written as a means of control over this critical area. These are safety and soundness considerations which do not place additional burdens on credit union management.

The delinquent loan reserve requirement has been modified to substitute, in the reserving requirement, 100 percent of loans coded "C" in examination reports for 80 percent of loans coded "C". This is consistent with the examination recommendation that loans coded "C" be included in a special loss reserve or considered for charge off. Timely recognition of loan losses ensures financial integrity.

The final change under delinquent loans is in regard to accounting for interest earned not collected. This rule requires that accruing for interest earned not collected on a credit union's books be discontinued when accounts become delinquent more than 90 days. The purpose is to present the financial statement at market value rather than on an ongoing concern basis. The rule allows

unearned interest to be reversed to accumulated earned when a loan is charged off or fully reserved for. Again, the purpose is to maintain financial integrity.

FIDELITY BOND

Major revisions were made in this section of the rules. The requirement of protection against lack of faithful performance has been removed and the schedule of basic coverage has been deleted. The rule now requires the credit union's board of directors to review and establish the amount of fidelity insurance annually. This provides management with greater flexibility, is consistent with other financial institutions and should result in less expense for some credit unions.

INSURANCE

Reimbursement from insurers for ministerial tasks not to exceed ten percent of gross premiums has been deleted to be consistent with authority granted by Minnesota Statutes, Section 52.04, Subdivision 1, Paragraph (13).

Additional changes in wording were made to facilitate ease in reading and understanding. The redrafting of the rules was done in the spirit of deregulation to rewrite sections which were unclear or no longer necessary while including items to ensure the safety and soundness of credit union operations. Expense considerations in the implementation of rule requirements were weighed in all cases. The conclusion is that the rules contribute to satisfying a need

to maintain safety and soundness in the operations of credit unions. The rules are not overly burdensome and increased costs will not result from their implementation. Based on these factors and as determined by industry representatives including two credit union trade associations and their counsel, the rules are reasonable.