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CREDIT UNION EXECUTIVE NEWS

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FRB REVISES RULES FOR ELECTRONIC DISCLOSURE DELIVERY

Effective December 10, 2007, the Federal Reserve Board (FRB) amended and finally established a mandatory compliance date to its "interim final rules" related to the timing and delivery of electronic disclosures. The FRB's revisions finally bring certainty to credit union compliance in providing account disclosures, e-statements and e-notices electronically.

After the federal E-sign Act was enacted in 2000, credit unions could begin to provide for "paperless" account opening and delivery of e-statements with relative compliance certainty. The primary requirement was obtaining a "Consent Notice" from the member that described the scope and terms under which required consumer disclosures, such as account opening disclosures, e-statements, annual notices, etc. could be provided online or through email.

In 2001, the FRB adopted interim final rules to establish uniform standards and additional delivery requirements and for electronic delivery of disclosures under Reg. B, E, M, Z and DD (Truth-in-Savings). However, within six months, the FRB suspended its October 2001 mandatory compliance date due to industry comments and resistance. Since that time, the FRB has not taken any further action to revise or clarify the rules.

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VISA FOREIGN CURRENCY FEE CHANGES AGAIN

In December, VISA announced that it was revising its foreign currency fees (International Service Assessment or ISA) yet again. A new ISA fee of .80% will apply to international single currency transactions processed by VISA effective April 2008.

This may sound pretty familiar to credit unions. In 2005, VISA reviewed its currency calculation and imposed the ISA upon credit union card issuers. The current ISA fee applies to all international multi-currency transactions (transactions that occur in a foreign county and processed in a foreign currency). VISA is now extending the ISA fee to all international single currency transactions (foreign transactions processed in U.S. dollars).

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ELECTRONIC DISCLOSURE (CONT.)

One area with which credit unions have struggled in terms of operations and compliance has been the standards for delivery or redelivery of disclosures via email. Disclosures could be sent to an email address designated by the member or could be made available on the credit union's website. If the disclosures, particularly e-statements, were not sent by email, credit unions would have to provide a notice to members (typically by email) alerting them to the availability of disclosures. Many credit unions have experienced difficulty with the email alert requirement. Other requirements of the FRB's interim final rules included: (i) disclosures posted on a website needed to remain available for 90 days; and (ii) good faith attempts to redeliver electronic disclosures returned undelivered.

Based on six years of review (and few consumer complaints or problems) the FRB is now calling the interim final rules "final"; with a mandatory effective date of October 1, 2008. The final rules also relax the previous interim rules by deleting the requirements for email alerts for e-statements, the 90-day website retention provision, and the requirement to search records for other addresses to redeliver disclosures when electronic delivery is returned undeliverable.

Thus the FRB is allowing credit unions full flexibility to use whatever method of electronic delivery best suited to the particular type of disclosure to be delivered. However, the initial Consent Notice would need to inform members how and where they can access the electronic disclosure they have elected to receive, whether via website or email.

Brian Witt

CURRENCY FEE CHANGES (CONT.)

As before, if a credit union wants to pass the fee on to its cardholders, the credit union card disclosures and agreements must provide for the imposition of the fee. Do credit unions need to revise card agreements and send change in term notices again?

That depends on the ISA fee disclosure you implemented last time. The information VISA provided processor and card issuers for the ISA fee in 2005 did not distinguish between multi and single currency transactions, but only referred to foreign transactions generally. Accordingly, most credit unions changed their card agreements to generally provide for a 1% foreign transaction fee (in any currency). For credit unions who have disclosed their fee in this fashion, you may not need to make any further disclosure changes to accommodate VISA's upcoming changes in April. However, you should consult with your card processor to make sure the fees that will show up on your members' statements are consistent with your card agreement and disclosures.

Brian Witt

FRB PROPOSES MAJOR OVERHAUL OF REG Z OPEN END DISCLOSURES

One of the most significant regulatory issues of 2007 was the FRB's proposed overhaul of the open end disclosure rules under Regulation Z. The proposed changes affect each one of the open end disclosures a credit union provides during the life cycle of the account: advertising, application disclosures, account opening, periodic statements; and changes in terms. In addition, the FRB is reexamining multi-featured open end plans that offer subaccounts with closed end features. Under the proposal, this type of account must be treated and disclosed as a closed end account.

The FRB's proposed changes to Reg. Z may occur as early as mid-year and the impact on credit unions will be significant. However, we do not believe this spells the end to open end lending for credit unions.

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MAJOR OVERHAUL OF REG Z OPEN END DISCLOSURES (CONT.)

Background

The FRB's proposed open end credit changes are not a surprise by any means. First, the FRB announced three years ago in an Advance Notice of Proposed Rulemaking (ANPR) that it would begin to reexamine Reg Z in its entirety, but in phases. Open end credit just happened to be first up. Second, in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congress amended the Truth in Lending Act (TILA) to add a number of new requirements and disclosure changes related to credit card disclosures. One interesting aspect that shaped the FRB's proposed changes was the FRB's use of consumer testing to better understand the utility of disclosures in consumers' credit card account shopping and selection. After nine months of testing and interviews with consumers, the FRB concluded that if disclosures are not in a box, consumers generally do not read them. This shaped the FRB's proposed rule.

Overview of Proposed Rule

The proposal affects all open end disclosures with some element of a "boxed disclosure" format.

Application Disclosures - six major changes were proposed to the Schumer box disclosures, generally adding more terms.

Account Opening Disclosures - a new Fed box similar to the Schumer box, was proposed along with added fee disclosures.

Periodic Statements - of all areas, periodic statements were hit with the most significant changes, particularly credit card statements and the need to disclose the effects of making only the required minimum payments. Good luck working with your statement provider on these requirements.

Change in Terms Notices - in addition to a new tabular based format the lead time for change in terms notices increased from 15 to 45 days.

Advertising - a number of new advertising disclosures were proposed to address minimum payment promotions and fixed rate change practices.

Open End/Closed End Features: The FRB's focus to reexamine closed end characteristic of open end plans was not addressed in its 2004 ANPR, nor was the origin or any consumer abuse discussed in the introductory material to the proposed rule. However the FRB did not launch this one based on any consumer focus group feedback.

The FRB's proposal is actually pretty simple. If an open end plan provides multi-featured subaccounts with fixed repayment periods and subject them to separate credit evaluations, such accounts will be treated as closed end accounts, for which closed end disclosures are required. Basically, the FRB is proposing that open end lending involve solely lines of credit and not any installment type credit accounts with fixed repayment periods. This hardly spells the end of open end lending, but it certainly may impact larger forms vendors whose loan systems promote such features. The proposal will require credit unions to reexamine the terms of their open end credit plans. Some may find it easier to go closed end. Others may get creative and find opportunities to restructure their entire lending relationship with members. After 30 years maybe it is time for a change.

Farleigh Witt is carefully watching the FRB's actions for open end lending. Because we have developed and supported open end loan documents and programs for credit unions throughout the country, we are keenly aware of the significant impact these changes may have. As the FRB further reviews and publishes final changes, we will advise our clients regarding the necessary document and operational changes. We are currently researching and developing a new open end loan model to meet the FRB's expectations yet preserving credit unions' unique lending practices.

Brian Witt

The proposal will require credit unions to reexamine the terms of their open end credit plans.

NCUA ISSUES FEDERAL CREDIT UNION RECORDS ACCESS RULE

Despite strong opposition and questionable need, NCUA adopted its new member rights regulation, Member Access to Accounting Books and Records. The new regulation grants members of FCUs significant new rights to gain access to credit union books and records and provides NCUA Regional Directors with expanded enforcement authority.

The new regulation is one of a series of recent NCUA actions that restrict FCUs' ability to establish balanced corporate governance policies and vest NCUA with increased regulatory control—all without a single change to the Federal Credit Union Act. The rule applicable only to FCUs became effective November 2, 2007.

Overview of New Rule

Member Inspection Rights. Members of FCUs, as a group, now have a right to petition the FCU to inspect and copy nonconfidential portions of the FCU's books, records and minutes of member, board and committee meetings. It will take at least 1% of the FCU members (maximum 500) who have been members at least 180 days to form a recognizable group with inspection rights. Neither smaller groups nor individual members enjoy such rights.

Scope of Records Access. There are few limits on the scope of FCU records subject to access. Members may seek access to any nonconfidential operational documents, legal documents, minutes of any Board, Committee or member meeting, including Executive Committee meetings. A FCU can still protect confidential portions of these records if the publication could cause the FCU predictable and substantial financial harm or if the record contains information about FCU employees or officials and the disclosure would constitute a clearly unwarranted invasion of personal privacy. Of course, if disclosure of a record is prohibited by law, members would have no right to access such documents.

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Inspection Petition. The records inspection petition must set forth the following:

- Description of a particular record and statement a proper purpose for the inspection (A proper purpose is one that relates to protecting the members' financial interest in the FCU);
- The members' agreement to pay search and copy costs;
- A statement that the purpose is not to sell FCU information; and
- A representative of the petitioners.

The FCU would have 14 days to review its records and respond to the petitioners, informing them of the records that will be provided and those records that are protected and the reasons for such protection. The FCU may charge direct and reasonable costs for search and copying but not other costs or attorney fees.

Dispute Resolution. If the petitioners do not like the FCU's response regarding an inspection petition request, they may submit the dispute to the NCUA Regional Director. The Regional Director's decision to uphold the FCU's protection of records or compel disclosure is regarded as a final agency decision and is not appealable to the Board. This means that the Regional Director's decision can only be appealed or challenged by seeking a federal declaratory judgment or injunction to invalidate the NCUA Regional Director's decision. Neither the FCU nor the members can seek any local judicial remedy or even a mutually agreed arbitrator or mediator.

No Confidentiality Protection

The most troubling part of NCUA's rule is the lack of any confidentiality protection that is given to any record or information provided pursuant to a petition. Once the FCU document or information is disclosed, the petitioners are free to do anything with the records, short of selling the information. Because of this lack of protection, it is imperative that a credit union protect its records with comprehensive policies and records management practices to designate appropriate portions of its books and records as "confidential" and not subject to petition access. Without such a designation, records may be more easily accessed by petitioner.

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RECORDS ACCESS RULE (CONT.)

Recommendation for FCU Policy

The new records inspection rule creates many open or gray areas that FCUs should consider a Board policy to clarify and provide evidence to administer records inspection requests. Areas we believe FCUs should carefully review and address include:

- Confidential Records. Determine as a matter of policy and practice, which FCU books, records and documents are considered confidential or proprietary. The Board may wish to review past Board minutes to designate which portions are considered confidential. Once the FCU is hit with a petition, this type of review and designation will appear suspect.

- Petition Procedures. Prepare a standard petition form to be provided and petition gathering procedures. This may assist the FCU in validating petitioner signatures. In light of the ability of Wings Financial FCU to gather online signatures in a matter of hours or days, don't think the 1% threshold is unachievable or unlikely.

- Search and Copy Charges. Establish and publish those fees ahead of time so there is less room for dispute over them.

- Consider types of FCU books and records that will be provided to individual members without a petition and the procedures for administering them. Establish policies and procedures to respond to requests.

FCUs cannot afford to have NCUA dictate their corporate governance policies and practices on an ad hoc basis or anytime NCUA dislikes state court decisions. FCUs should take a protective approach to implement balanced and comprehensive corporate governance policies to protect the FCU's records and afford all members a reasonable right of access to FCU records.

Brian Witt

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NEWS & UPCOMING EVENTS . . .

CUNA Volunteer Institute – Karen Saul just returned from Mexico and the Credit Union National Association's Volunteer Institute where she presented a breakout session on how to conduct an effective CEO evaluation.

Western States Volunteer Conference – Michelle Holman Kerin will be speaking at the Western States Volunteer Conference at the Monte Carlo Resort in Las Vegas on February 11, 2008 on two hot topics: (1) Sarbanes-Oxley and Your Credit Union; and (2) What Board Members Need to Know About Discrimination.

NCUA GRABS FULL CONTROL OVER FCU BYLAWS

Effective December 1, 2007, NCUA adopted final regulations to incorporate the FCU Model Bylaws into NCUA Reg. 701.2. While NCUA characterizes the final Bylaw rule as creating "no new regulatory burden," the rule affords NCUA greater enforcement authority and nearly full control over all aspects of bylaws for FCUs.

Overview of FCU Bylaw Rule

NCUA's rule makes the following key changes regarding the adoption, interpretation and dispute resolution of FCU Bylaws:

1. *Regulatory Supervision.* Now that the FCU Bylaws are part of Reg. 701.2, NCUA has full control over interpretative issues and corporate governance policies of FCUs. NCUA need not look to any state corporate law regarding corporate governance issues.

2. *Bylaw Dispute*. The rule now establishes a Bylaw dispute resolution and member complaint process that leaves the ultimate determination with the NCUA Regional Director. FCUs and members will no longer have any recourse in state court to seek protection or settle disputes. If the NCUA Regional Director's decision is unacceptable, the only option is to challenge that decision in federal court.

3. *Expedited Approval*. For any nonstandard and FCU Bylaws that have been previously approved, NCUA will post those on NCUA's website and FCUs can seek a 15-day expedited approval of any previously approved Bylaws. (Unfortunately, now 45 days after this final rule, NCUA has yet to post any preapproved Bylaws.)

4. *Supervisory Committee and Successor Board*. NCUA adopted a new Standard Bylaw provision that declares the Supervisory Committee as the interim Board of Directors in the event of a successful petition to remove the entire Board of Directors (We do not recommend FCUs adopt the amendment as prepared by NCUA. The new provision raises more Bylaw and corporate governance inconsistencies and problems than it solves.)

The Real Problem Remains Unfixed

NCUA's new FCU Bylaw regulation is a predictable reaction to one specific case (DFCU Financial) that revealed the heart of the problem for FCU corporate governance—there are essentially no corporate governance rules in the Federal Credit Union Act (FCUA). There was a reason why NCUA had no ability to force DFCU Financial to hold a special meeting to remove the entire Board. First, a Michigan state court ruled that the act of removing an entire Board rendering the FCU without a Board was a violation of the FCUA. Second, NCUA had no direct, regulatory authority over DFCU Financial's Board corporate governance determinations.

In its new FCU Bylaw regulations, NCUA fixed the two issues it struggled over in the DFCU case. However, the real problem remains unfixed. Unlike most state credit union acts, the FCUA contains no corporate governance provisions, and the new NCUA bylaws do little to address key governance issues. These are now all within the NCUA's control.

Brian Witt

. . .the heart of the problem for FCU corporate governance—there are essentially no corporate governance rules in the Federal Credit Union Act (FCUA).

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ACCOUNT CARD CHANGES—IRS REVISED W-9 CERTIFICATION

One of the first compliance tasks for 2008 will be updating your Credit Union's Account (signature) Cards for consumer and business member deposit accounts.

In October, without any prior notice, the IRS introduced a number of changes to its Form W-9, Request for Taxpayer Identification Number and Certification. Credit Unions are required to obtain an executed Form W-9 or substitute W-9 for all nonexempt account owners, consumer and business, at the account opening. As permitted by IRS rules, credit unions have historically included a substitute W-9 in their Account Card rather than obtain the Form W-9. The recent IRS changes affect the substitute W-9 certification used for both consumer and business Account Cards.

Consumer Accounts. For Account Cards used for consumer accounts, there are two primary changes:

1. The TIN/SSN certification language has changed slightly; and
2. The Form W-9 instructions need only be provided upon request and not automatically provided with the Account Card or in the Account Agreement.

Business Accounts. For Account Cards used for business accounts, the same changes for consumer accounts apply, plus a requirement to capture more information on accounts of LLCs. For limited liability companies (LLCs) , you must ask for additional information in order to list the proper account owner and proper TIN for the LLC. As LLCs have become more popular as an entity for new businesses over the last few years, the IRS has continued to modify the tax rules and applicable taxpayer identification number for an LLC. For LLCs, the new Form W-9 asks the taxpayer to designate whether it is treated as a disregarded entity, corporation or partnership for tax purposes. For single-member LLCs, the member can elect to have the LLC treated as a "disregarded entity" for tax purposes. Accordingly, the LLC is simply disregarded or ignored for tax purposes as if it does not even exist. Accordingly, no tax return is required and no separate TIN is required of the LLC. Thus, the member's name and SSN is used to report any income attributable to the LLC and the SSN is the TIN the Credit Union will use to open the account. However, this does not affect the actual ownership of the account for other purposes such as garnishments, levies, or treatment of the account on death of a signer. For such purposes, the LLC is the owner of the account. The member of the LLC is merely a signer of the account.

Unlike most regulatory changes, the IRS changes are effective immediately. If you need assistance with Account Card updates or any deposit account documentation for consumer or business accounts, please feel free to contact Brian Witt or Hal Scoggins.

Brian Witt

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