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CREDIT UNION EXECUTIVE NEWS

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SAVECCU V. COLUMBIA CREDIT UNION—AN IMPORTANT DECISION ON MEMBERS' RIGHTS

On July 25, 2006, the Washington State Court of Appeals confirmed a trial court's earlier decision that SaveCCU's claims against Columbia Credit Union (CCU) and CCU's Board of Directors were without legal merit. The SaveCCU decision involved two important corporate governance issues that are significant for all credit unions: (1) board fiduciary duties; and (2) members rights to access records. The SaveCCU decision establishes helpful guidelines for credit unions as these issues have not previously involved credit unions, only corporations.

Corporate Governance Issues

SaveCCU had sought rulings from the appellate court on a number of issues related to conversion and corporate governance. The court declined to even consider SaveCCU's claims regarding the legality of the proposed conversion as the Credit Union was no longer seeking to convert to a bank. More importantly, the court affirmed the Credit Union's position on two primary corporate governance issues:

Fiduciary Duties. The court held that CCU Board members owe fiduciary duties to the Credit Union and not to individual members or any faction of members. Also, the court held that SaveCCU and the individual members do not have an express right to assert a direct claim against a director for breaching a fiduciary duty.

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HOME BANKING AUTHENTICATION—WHAT IS REQUIRED BY YEAR END 2006

Late last year, the FFIEC agencies (including NCUA) issued Guidance for Authentication in an Internet Banking Environment (Guidance). The FFIEC Guidance addresses the need for risk based assessments, member awareness and eventually, enhanced security measures to authenticate members using home banking programs. Last month, the FFIEC issued clarification in the form of Frequently Asked Questions (FAQs), to assist financial institutions in understanding the Guidance. Based on the guidance and recent FAQs, we felt it was important to outline for you what is truly required by year end 2006.

This summer we heard from many credit union clients who were being pressured by home banking providers stating that full implementation of new multi-factor authentication technology is required by year end.

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Inside this issue:

Board members owe fiduciary duties to the Credit Union and not to individual members or any faction of members.

SAVECCU (CONT.)

Any appropriate action would need to be brought by the Washington DFI or the Credit Union itself. Also, SaveCCU, itself, lacked standing to bring any breach of fiduciary duty claim on behalf of the Credit Union against the CCU Board.

Access to Records. The court held that CCU members do not have direct access rights to CCU's books, records, and computer files. Again, the Washington DFI has full access to the extent of any abuse. The court reasoned that credit union members resemble depositors in a bank more than corporate shareholders and, therefore, do not have the same protections afforded shareholders in corporations. The court held that the CCU Board properly protected the Credit Union records to which members do not have unchecked access.

Incidentally, the appellate court also denied SaveCCU's request for attorney fees for bringing the failed action "because they have not conferred benefit on the credit union or its members."

The Importance for Credit Unions

While the SaveCCU decision puts to rest some of the last issues of the Credit Union's attempted conversion from 2004, the case has long term importance for the entire industry in two respects. First, the decision addressed corporate governance issues that have been well examined for corporations, but not for credit unions. Given the lack of credit union precedent, the courts will certainly look to and apply corporate law. At the same time, the courts will consider the unique aspects of the credit union corporate structure. Second, some credit union commentators are critical of the decision as the court viewed credit union members closer to bank depositors than to corporate shareholders. However, most state credit union acts are similar to Washington and do not endow members with special "ownership" rights. Rather, members have specific membership rights to govern the credit union. While calling members "owners" has real promotional appeal, from a legal standpoint it is not accurate.

We encourage credit unions to take a proactive approach to corporate governance by updating bylaws and implementing comprehensive corporate governance policies to more clearly articulate the credit union's policies and procedures, the rights of members and applicable limitations of those rights.

Brian Witt

HOME BANKING (CONT.)

While credit unions must be diligent in approaching this issue, these sales pitches were a little extreme, as the Guidance does not require complete multi-factor authentication implementation by year end 2006.

Each credit union providing internet-based services needs to conduct a risk assessment of its authentication system by year end 2006 and determine necessary and appropriate authentication solutions for your products and services available over the internet. A risk assessment may conclude that existing controls are appropriate. However, NCUA has already warned that single-factor authentication is inadequate for home banking systems permitting high risk transactions (e.g., re-usable on-line applications, bill payments, cross account transfers or similar transfers of funds to other parties). In addition, according to the FAQs, credit unions are expected to implement risk mitigation "activities" by year end 2006.

We may have spoken to numerous NCUA staff on the extent of the "activities" to be implemented. This does not necessarily mean new technologies need to be purchased and installed. However, it is clear the risk assessment needs to be completed and to the extent additional mechanisms for adequate authentication are necessary, your credit union needs to have a written implementation plan that addresses when it will install such measures.

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HOME BANKING (CONT.)

We believe an implementation plan should address: (1) a review and selection of authentication solutions and providers; (2) due diligence; (3) contract negotiation; (4) installation schedule; (5) testing schedule; (6) compliance; and (7) member communications.

While neither the NCUA nor FFIEC has provided a template or any specific examination criteria for the risk assessment, some home banking providers are providing their clients with risk assessments as well as immediate authentication solutions. Credit unions should beware of quick solutions and carefully consider all compliance implications. For example, we recently learned from one credit union client that their newly implemented authentication system utilizes "cookies" to authenticate home banking users. Unfortunately, like many credit unions, this credit union has previously stated in its privacy notice that it does not use cookies for data purposes. So much for quick solutions.

> Credit unions should beware of quick solutions and carefully consider all compliance implications.

We have developed a written risk assessment and plan to assist credit union clients who need to document their efforts by year end 2006. Please contact us if you need assistance with your risk assessment.

Brian Witt
Hal Scoggins

REGULATORY HOT BUTTONS

Here are a few of the current regulatory hot buttons from NCUA and state regulators:

BSA Compliance – Risk Assessments

Bank Secrecy Act (BSA) compliance has been a hot button for both federal and state regulators for the last two years. As a result of NCUA's "no error tolerance" on CTR compliance, credit unions have experienced BSA exams lasting 5-10 times longer than normal. NCUA's latest hot button for BSA compliance is clear—risk assessments. Credit unions are frequently being written up for either a lack of BSA risk assessment or an inadequate risk assessment.

How have credit unions updated and operated BSA compliance programs, yet missed the risk assessment requirement? When the USA Patriot Act changes required BSA program updates, many of the requirements were "risk based" allowing each credit union to adopt procedures appropriate to that credit union's operations. However, the new regulations did not formally address the issue of risk based analysis, which was really left up to each credit union. In June 2005, the FFIEC published a comprehensive Bank Secrecy Act Anti-Money Laundering Examination Manual for all federal banking agencies (which was recently updated in July 2006). The Manual instructs examiners (and credit unions) that a "risk assessment" is a fundamental requirement to a financial institution's BSA program. A risk assessment involves identifying and measuring risk of the credit union products, services, members and geographical locations. The result of the risk assessment is to determine any necessary changes in the credit union's internal controls (policies, procedures, systems, etc.) to mitigate such risks. So, based upon the FFIEC's exam guidelines, credit unions need to complete and document risk assessment.

The FFIEC provides guidance on the necessary elements of a risk assessment at http://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_005.htm. Also, we have assisted credit union clients in formulating, conducting and documenting a BSA risk assessment.

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HOT BUTTONS (CONT.)

Website Compliance Reviews

A recent hot button in the state of Washington is the need for credit unions to conduct website compliance reviews. In July 2006, the Washington DFI issued its DCU Bulletin (B-06-04) regarding the examination of credit union websites. Based upon website compliance examination procedures previously issued by the FFIEC, DFI is now prepared to implement and apply these new exam procedures to Washington credit unions beginning August 31, 2006.

Advertising Compliance. For most credit unions, the examination of its website for compliance should result in few substantive compliance issues, as much of the exam process deals with the same advertising compliance requirements applicable to paper based promotions of accounts and services. Of course, this assumes your marketing department's paper based promotions (rate schedules, account and service brochures, etc.) are already in compliance. The DFI Bulletin lists the federal regulations that apply to the promotional content of credit union websites.

ESIGN Compliance. One critical area of credit union websites the DFI has not addressed is compliance with the online delivery of account disclosures and e-statements. These compliance requirements go beyond the routine advertising disclosures and involve website design issues, consumer consent notices, e-signatures and state law issues. Not only are the compliance and legal issues more complex than website advertising compliance, the consequences of noncompliance are much more severe. This potential hot button should be addressed now rather than later.

Prior to your next exam, consider having Farleigh Witt provide a website compliance review for your credit union. Our firm provides comprehensive website compliance reviews that do not end with a list of advertising compliance errors, but includes an analysis of online functions for e-sign compliance and all necessary content corrections for guaranteed compliance.

Brian Witt

WASHINGTON SUPREME COURT NARROWS THE DEFINITION OF DISABILITY

In an important decision for Washington employers, the Washington Supreme Court has narrowed the definition of "disability" under the Washington Law Against Discrimination ("WLAD"). In *McClarty v. Totem Electric*, the Supreme Court discarded the Washington Human Rights Commission's ("HRC") broader definition of disability and adopted the Americans with Disability Act's ("ADA") definition for purposes of the WLAD. We believe the *McClarty* decision is favorable for credit union employers as it should reduce the scope of disability claims employees can bring.

Factual Background

In April 1998, Kenneth McClarty's union dispatched him to Totem Electric, a contractor for a high school renovation project. McClarty's position required repeated use of a jackhammer and shovel to level trenches and install pipe. After three months on the job, he complained of pain in his hands and was diagnosed with bilateral carpal tunnel and received doctor specified work restrictions. On the same day that he provided his employer with the work restrictions, he was terminated with the reason cited: "reduction in work force/lay-off." A week later, Totem Electric hired two apprentices at lower rank and pay. McClarty sued Totem Electric for disability discrimination under the WLAD. The trial court sided with the employer, but the Washington Court of Appeals reversed. The Washington Supreme Court granted the employer's petition for review to determine the proper definition of "disability" under the WLAD.

The Court's Holding

In a surprising decision, the Court rejected outright the broad definition of "disability" used by the HRC in interpreting the WLAD. It found that the HRC definition, which employers in Washington have been using since 1975, was too broad and noted that even a receding hairline could be considered a disability under the HRC's definition. The Court also rejected prior Washington cases and adopted the federal ADA definition for the term "disability" as a single definition that could be used consistently throughout the WLAD.

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WLAD (CONT.)

What This Means For Employers

The narrower definition of disability is favorable for employers. Not only does it reduce the scope of potential disability claims, it provides more certainty and consistency with respect to the analysis of what constitutes a disability. Under *McClarty*, a plaintiff bringing suit under the WLAD establishes that he or she has a disability if he or she: (1) has a physical or mental impairment that substantially limits one or more of his or her major life activities; (2) has a record of such an impairment; or (3) is regarded as having such an impairment. Employers should still be cautious when dealing with an employee who seeks a change in the work environment as an accommodation for a claimed disability. However, in analyzing whether an employee has a disability under the WLAD, employers may now look to case law that interprets the federal ADA definition. Unfortunately for aging male Credit Union employees, the receding hairline claim won't make it after the *McClarty* decision.

Michelle Kerin

Please visit our new website:
www.farleighwitt.com

NEW NCUA INSURANCE SIGNS—NOT YET

Earlier this year, the Federal Credit Union Act was amended to increase the insurance coverage for certain retirement accounts, including IRAs (traditional and Roth) and Keogh accounts - up to $250,000. The increased insurance coverage is separate and apart from the $100,000 insurance coverage on other credit union accounts. While the new insurance limits are effective, the new NCUA official insurance signs are not.

NCUA has proposed revisions to the Official Sign and the comment period just ended. Therefore, do not expect the final Official Sign rules until mid-fall and understand there will be a reasonable period of time (proposed 60 days) to get the new signs displayed. NCUA will be providing credit unions with an initial supply of the Official Sign at no cost and will make the downloadable image available on the agency's website. In the final rule, NCUA will inform credit unions how and when they will receive the signs.

Credit unions will not be in violation of NCUA insurance rules unless they fail to display the revised signs within the specified "grace period" **after** they are available.

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NEW PODCAST—CURRENT ISSUES IN CREDIT UNIONS

Earlier this summer Brian Witt helped launch a new podcast for credit unions: *Current Issues in Credit Unions* (CIiCU). CIiCU is hosted by attorneys involved in the credit union movement and is a podcast about credit unions and current legal issues they face. Brian is joined by co-hosts Gwen Baker of Venable LLP in Washington, D.C., Guy Messick of Messick & Weber P.C. in Media, PA, and Rob Rutkowski of Weltman, Weinberg & Reis Co., L.P.A. in Cleveland, OH. The podcasts are designed for credit union officers, directors, employees, volunteers, and anyone interested in the CU movement. The CIiCU team has just completed their fourth monthly podcast. The podcast is accessible on the Internet through the iTunes Music Store or direct download www.ciicu.libsyn.com.

In earlier podcasts, Brian and the rest of the CIiCU team addressed data security issues, courtesy pay, CUSO taxation updates, pay day lending, BSA and SAR compliance, multi-factor authentication, CEO compensation issues, CU Bylaws and Board governance best practices, and many others. NCUA Board member Gigi Hyland was a guest on the July podcast. http://www.ncua.gov/news/press_releases/2006/MA06-0801.htm and Trey Reeme of the Open CU Source joined the August podcast.

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Credit Unions interested in accessing the podcasts can visit any of the links below. iPods can be used to listen to the podcasts, but they are not necessary. The podcasts can be easily downloaded and listened to as a file on the computer, or the file can be burned onto an audio CD for use in a CD player. iTunes Music Store: http://phobos.apple.com/WebObjects/MZStore.woa/wa/viewPodcast?id=151785964&s=143441 Direct Download: www.ciicu.libsyn.com RSS Feed: http://ciicu.libsyn.com/rss

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Brian Witt