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February 28, 2013

"A"
"B"

RE: State Credit Union Investments in Employee Benefit Trusts

DCU Interpretive Letter I-13-02

Dear "A":

You have inquired of the Division of Credit Unions ("Division") of the Washington State Department of Financial Institutions ("DFI") whether a Washington state-chartered credit union ("State Credit Union"), including "B", may fund employee benefit obligations through an employee benefit trust holding investments that are otherwise impermissible for a State Credit Union. This inquiry has been forwarded to me for response on behalf of the Division in my capacity as general counsel for the DFI.

1.0 Determination

The Division makes the following determination with respect to your inquiry:

1.1 Federal Parity. Pursuant to federal parity as hereinafter discussed in *Sections 2.2 and 2.3* below, a State Credit Union may make investments *to fund employee benefit obligations* that would otherwise be impermissible for the State Credit Union investing on its own behalf.

1.2 Required Regulations. Investments to fund employee benefit obligations will be subject to restrictions set forth in certain regulations of the National Credit Union Administration

("NCUA")[1] rather than DFI regulations set forth in the Washington Administrative Code ("WAC").[2] See *Section 2.4* below.

1.3 Employee Benefit Trust. As a vehicle to fund employee benefit obligations, a State Credit Union must establish a trust using the general standards set forth in *Section 2.5*.

2.0 Discussion

2.1 DFI Regulation of State Credit Union Investments – Generally. The Washington Credit Union Act ("Act") provides a list of permissible investments for State Credit Unions. The list includes loans held by other credit unions, state, local, or federal bonds or securities, other government guaranteed investments, obligations of quasi-government organizations such as the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA), deposit accounts at other financial institutions, mutual funds investing in government securities, and certain other investments not relevant to this interpretive statement.[3] The Act also permits State Credit Unions to make other investments if approved by the DFI after written application by the State Credit Union.[4] DFI regulations provides rules and procedures for DFI approval of investments not otherwise permitted by law, including (1) information to be submitted to the DFI, (2) standards for approval by the DFI, and (3) restrictions and requirements applicable to investments in common trust funds.[5]

2.2 Applying the Act's Federal Parity Statute. If a State Credit Union were to rely solely on the foregoing authorities, it would need to obtain DFI approval in order to invest in an employee benefit funding trust holding otherwise impermissible investments. However, the Act includes a federal parity provision, which declares:

> "Notwithstanding any other provision of law, and in addition to all powers and authorities, express or implied, that a credit union has under the laws of this state, a credit union has the powers and authorities that a federal credit union had on December 31, 1993, or a subsequent date not later than July 22, 2001."[6]

[1] *See* NCUA Rules, 12 C.F.R. Part 703.

[2] *See* Chapter 208-436 WAC.

[3] *See* RCW 31.12.436.

[4] *See* RCW 31.12.436(11).

[5] Chapter 208-436 WAC.

[6] The Act, at RCW 31.12.404.

This provision further provides that a State Credit Union may exercise powers available to a federal credit union after July 22, 2001, but only if the director of the DFI[7] makes a finding that exercise of a power of a federal credit union serves the convenience and advantage of State Credit Union members, and maintains fairness of competition and parity between State Credit Unions and federal credit unions. Exercise of the federal parity power is subject to all restrictions, limitations, and requirements that apply to a federal credit union exercising that power.

Although DFI regulation requires a State Credit Union to obtain DFI approval to make investments that federal credit unions have previously received permission to make,[8] this regulation applies to investments made by the State Credit Union *on its own behalf*, and not to investments made to fund employee benefit obligations pursuant to the federal parity provision. All of the restrictions and requirements outlined in the State Credit Union investment regulation[9] are directed at the credit union's investment of funds *for its own benefit for the purpose of generating income*. However, investments made to fund employee benefit obligations do not fall into that category precisely because they are made not for the credit union's own benefit but for the benefit of its employees.

DFI rule[10] implements the authority specifically granted in the Act to make other investments if approved by the DFI after application by the State Credit Union.[11] However, the above-cited federal parity power is available notwithstanding any other provision of law and is in addition to any other Washington law or regulation available to a State Credit Union.

Accordingly, if a federal credit union has the power to fund employee benefits through investment in an employee benefit trust that holds otherwise impermissible investments, and had that power *before July 22, 2001*, such power is presently available to a State Credit Union.

2.3 Availability of Federal Credit Union Power. NCUA regulations provide that:

> "A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and part 703 or, as applicable, part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long

[7] The DFI director has generally delegated his authority to the Division Director for purposes of administration of the Act.

[8] *See* WAC 208-436-040.

[9] Chapter 208-436 WAC.

[10] WAC 208-436-040.

[11] See RCW 31.12.436(11).

> as it has an actual or potential obligation under the employee benefit plan."[12]

The NCUA adopted the above-referenced regulatory provision in 2003. However, in doing so, NCUA declared that it was merely codifying its long-standing interpretation of the Federal Credit Union Act as set forth in previous NCUA general counsel opinion letters.[13] So federal credit unions have had the power to make otherwise impermissible investments to fund employee benefit obligations since *before December 31, 1993*.

Accordingly, a State Credit Union may exercise the same power pursuant to the Act's federal parity statute[14] without seeking approval from the DFI.

2.4 State Credit Union Exercise of Federal Credit Union Power. Pursuant to NCUA regulation,[15] a federal credit union may invest in otherwise impermissible investments *subject to three specific limitations*:

2.4.1 *The investment must be for the purpose of funding "an employee benefit plan" obligation*. NCUA regulation provides that the term "employee benefit plan" has the same meaning as set forth in the Employment Retirement Income Security Act ("ERISA"), at 29 U.S.C. §1002(3).[16] This ERISA provision states that "employee benefit plan" includes plans that are employee welfare benefit plans or employee pension benefit plans, or plans which are both. An employee pension benefit plan includes plans designed to provide retirement income to employees or resulting in deferral of employee income for periods extending through termination of covered employment or beyond. This ERISA provision also defines an "employee welfare benefit plan" as an employee benefit plan established for those providing medical, surgical, or hospital care or benefits, or other benefits related to sickness, accident, disability, death, or unemployment, vacation benefits, apprenticeship or other training programs, daycare centers,

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[12] NCUA Rules, at 12 C.F.R. §701.19(c).

[13] For example, General Counsel Opinion No. 94-0109 states:

> "While an FCU [federal credit union] investing on its own behalf would be restricted by the investment provisions of the FCU Act and the NCUA Rules and Regulations . . . those provisions do not apply when the FCU as the employer is acting pursuant to its authority to provide retirement benefits to employees. The authority of an FCU to provide benefits to its employees is separate from its general investment authority and is not subject to the same limitations."

The opinion letter refers to previous NCUA general counsel opinions dating as far back as May 29, 1987. This particular opinion letter related to the credit union's obligations under a deferred compensation plan, but was not limited to that particular application. One of the other opinion letters cited in this letter relates to post-retirement health insurance benefits.

[14] RCW 31.12.404.

[15] NCUA Rules, at 12 C.F.R §701.19.

[16] *Ibid.*

scholarship funds, or prepaid legal services, or any other benefits described in ERISA, at 29 U.S.C. § 186(c).[17]

2.4.2 *The investment must be "directly related to" the credit union's obligation or potential obligation*. Under the NCUA regulation, a credit union must be able to demonstrate that the otherwise impermissible investments are "directly related" to the credit union's benefit obligations.[18] The credit union may not invest more than is necessary to fund the benefits in question. This calculation is performed by determining (as closely as possible) the amount of the credit union's anticipated benefit obligation and determining the amount that must be invested based on the anticipated rate of return in order to fund that obligation.[19] This amount will allow the credit union to recoup its initial investment as well as the amount necessary to fund the employee benefit obligation. In addition, the credit union may also invest enough to recover its costs associated with the benefit and cost of funding.

2.4.3 *The credit union may hold the investment only for the period during which it has an actual or potential obligation under the plan in question*. The credit union may only hold such impermissible investments for as long as the credit union has an employee benefit obligation that the investments are intended to fund. Thus, for example, if the credit union holds an investment for the purpose of funding retirement benefits for a particular employee and the employee retires and the obligation is paid, the credit union must divest of the investment unless it has incurred additional employee benefit obligations that would replace the original one and would be directly related to the investment in question.

2.5 Required Standards for Employee Benefit Funding Trust. For ease of administration and to effectively segregate employee benefit plan investments from investments made on the credit union's own behalf, a State Credit Union should establish an *employee benefit funding trust* using a trust agreement. A proper trust agreement, in this context, must: (1) Establish the trust; (2) provide that trust funds will be invested and used exclusively to fund employee benefit plan obligations; (3) prohibit commingling or use of the funds for any reason other than funding employee benefit plan obligations; (4) appoint a trustee; (5) permit the State Credit Union to change the trustee at any time; and (6) provide for the parties to adopt an investment policy regarding investment of the funds.

The trust must not be a common or pooled trust but rather an individual trust established for a single employee benefit plan obligor.

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[17] ERISA, at 29 U.S.C. § 186(c), further describes benefits such as sickness, insurance, vacation benefits, training programs, etc. We need not examine those benefits further for the purposes of this letter, except to recognize that they exist. For most credit unions, the largest employee benefit plan obligations by far are those related to retirement, health insurance, and leave for sickness and vacation.

[18] The NCUA has indicated that this can be demonstrated through information in the credit union's records such as employee benefit plan documents, benefit obligation calculations, and calculations matching the amount of the investment and anticipated return to the credit union's obligation.

[19] For example (as indicated in NCUA General Counsel Opinion No. 2003-0512), if a credit union has an anticipated employee retirement benefit of $500,000, the credit union may invest $250,000 in an investment reasonably expected to yield $750,000 at the time the retirement obligation matures.

The trust agreement must require separate investment accounts for different employee benefit obligations in order to more effectively tie the investment account(s) to the obligation(s) in question and to ensure that the trust investment does not exceed the anticipated amount of the obligation.

The trust must require the State Credit Union to complete a funding worksheet before investing any funds in the trust. The funding worksheet should generally be designed to calculate the amount that would be necessary to fund the entire employee benefit obligation based on when the obligation will mature and the trust's anticipated rate of return. The worksheet must generally include both an assessment of the amount necessary to fund the employee benefit obligation and to cover the cost of funds invested in the trust.[20] The amount of funding in relation to the amount of the employee benefit plan obligation must be re-assessed each year.[21]

The terms of the trust, along with the funding worksheet, must appear designed to ensure that the investment arrangement satisfies the NCUA requirements set forth in *Section 2.4* above.

An individual trust is not, in and of itself, an investment. Rather, the trust is a vehicle that a trustor may use to make investments or otherwise handle assets. The trust must explicitly provide that the trustee may not exercise any trust power in a manner that would violate NCUA Rules, at 12 C.F.R. §701.19.

Therefore, a trust established in accordance with the requirements set forth above in *Section 2.5* hereof will be deemed by the Division a permissible vehicle for investments to fund employee benefit plan obligations of a State Credit Union.

However, the Division expresses no opinion as to whether any particular trust agreement satisfies the needs of any State Credit Union or as to whether calculations performed using any particular funding worksheet will accurately assess a credit union's maximum permissible investment to fund employee benefit plan obligations.[22]

3.0 Conclusion

Based on the foregoing, a State Credit Union, including "B", may make investments that are not otherwise permitted to State Credit Unions (absent Division approval) for the express purpose of funding employee benefit obligations. In making such investments, a State Credit Union is subject to all of the limitations set forth in the afore-mentioned NCUA regulations and other

[20] *See* NCUA Rules, at 12 C.F.R. §701.19, and NCUA General Counsel Opinion No. 04-0453.

[21] The Division does not here prescribe any set model or formulation for the above-referenced funding worksheet. A funding worksheet that reasonably applies the requirements of this interpretive statement will be deemed sufficient at this time. However, the Division may by guidance or rule propound in the future a model worksheet consistent with the requirements of this interpretive statement.

[22] A funding worksheet may indicate that an investment should be adjusted if it exceeds or falls short of the target investment amount by more than a specific percentage. There does not appear to be any authority that would specify any particular margin by which an investment could exceed a target amount and still be permissible. However, the conduct of the State Credit Union with respect to the trust will always be measured by general principles of safety and soundness.

NCUA authority interpreting or applying those regulations.[23] Finally, an employee benefit plan trust established under the standards set forth in ***Section 2.5*** above is a permissible vehicle for a State Credit Union to make investments to fund employee benefit obligations.

If you have any questions, please do not hesitate to call upon the Division of Credit Unions, by and through Linda K. Jekel, Director of Credit Unions, at linda.jekel@dfi.wa.gov, or (360) 902-8778.

Yours very truly,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL INSTITUTIONS

DIVISION OF CREDIT UNIONS

By:
Joseph M. Vincent
General Counsel
/s/
Cc: Harold B. Scoggins III, Esq.

[23] The Division may propound special rulemaking in the future related to employee benefits trusts, not inconsistent with the afore-mentioned NCUA rules and associated interpretations.