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DCU Opinion Number 01-8

Date: November 2, 2001

From: Parker Cann, Director of Credit Unions

Subject:
Credit Unions Possess Incidental Powers through Two Sources -
1. The State Parity Provision (RCW 31.12.404); and
2. The State Incidental Powers Provision (RCW 31.12.402(23))

By: Parker Cann, Director of Credit Unions

Issue – State Parity Provision

The Washington State Credit Union Act (WSCUA) grants Washington State-chartered credit unions (WaSCUs) the powers and authorities (powers) that federally-chartered credit unions (FCUs) possessed on December 31, 1993 or a subsequent date not later than July 22, 2001. RCW 31.12.404 (state parity provision). In addition, the Director of the Department of Financial Institutions (DFI) may grant WaSCUs the powers and authorities that FCUs have subsequent to July 22, 2001

> … if the director finds that the exercise of the power and authority serves the convenience and advantage of members of credit unions, and maintains the fairness of competition and parity between credit unions and federal or out-of-state credit unions.

RCW 31.12.404(2). The Director's power to reach such a finding and to interpret Chapter 31.12 RCW generally has been delegated to the Director of the Division of Credit Unions. Of course, in exercising an FCU power, WaSCUs must comply with any restrictions or limitations on the specific exercise of the power under NCUA statutes or rules. RCW 31.12.404(3).

The Federal Credit Union Act (FCUA) provides that a FCU has the power to

> exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated.

12 U.S.C. Section 1757(17). On September 5, 2001, the National Credit Union Administration (NCUA) amended its rules to grant FCUs broader incidental powers under the FCUA. 12 C.F.R.

Part 721; see also 66 Federal Register 40845 – 40859 (August 6, 2001) (NCUA's amended IP rule).

In part, the NCUA's amended IP rule also outlined a three-part test to determine what activities fall within the purview of incidental powers. See 12 C.F.R. Section 721.2 of the rule. The test was derived from the U.S. Supreme Court decision in Nationsbank of North Carolina v. Variable Annuity Life Insurance Co., 513 U.S. 251 (1995) (VALIC).

The Washington Credit Union League (WCUL) has inquired whether WaSCUs enjoy the same incidental powers that were granted to FCUs by the NCUA's amended IP rule.

Analysis – State Parity Provision

As noted above, WaSCUs are granted FCU powers in effect on December 31, 1993, or a subsequent date no later than July 22, 2001. RCW 31.12.404(1). A finding by the Director is not required to grant WaSCUs any FCU power unless it took effect after July 22, 2001.

In regard to interpretation of the state parity provision, the Division continues to take the position that the effective date of a power derived from the FCUA is based on the enactment of the FCUA provision, even though the power is not recognized or acknowledged by NCUA rule or interpretation until later. Such is the case in this instance.

The NCUA's amended IP rule took effect on September 5, 2001. However, the incidental powers provision in the FCUA was in effect on July 22, 2001. Consequently, the state parity provision does grant the incidental powers recognized in the NCUA's amended IP rule, without the need for a finding by the Director under RCW 31.12.404(2).

Conclusion – State Parity Provision

We conclude that WaSCUs possess the powers granted to FCUs by the NCUA's amended IP rule. This includes incidental powers and authorities granted to a FCU in the future through application to the NCUA or opinion of its General Counsel. As is the case with the exercise of any parity power, a credit union should:

A. Consider whether Board of Directors' approval of the exercise is necessary;
B. Maintain legal citations and other documentation evidencing the FCU power and the restrictions and limitations on the power; and
C. Comply with the NCUA restrictions and limitations on the power.

State Incidental Powers Provision

The WSCUA also grants WaSCUs certain incidental powers. A WaSCU may:

exercise such incidental powers as are necessary or convenient to enable it to conduct the business of a credit union.

RCW 31.12.402(23) (state incidental powers provision). Although we have not been asked to opine on this provision, we feel that it would be helpful to WaSCUs to explain the application of this provision in the context of this opinion.

We believe that WaSCUs may possess incidental powers under the incidental powers provision that are different than the incidental powers they possess under the state parity provision, as determined above in this opinion. In addition, we would like to note that we intend to use the test outlined in VALIC as a test for determining what is an incidental power for WaSCUs under RCW 31.12.402(23).

Exercising Incidental Powers

A WaSCU should obtain the Division's written approval before undertaking any new activity in exercise of its incidental powers under either the state parity provision or the state incidental powers provision, unless:

1. The activity is within a category that has been preapproved by the NCUA under 12 C.F.R. Section 721.3;
2. The activity has been approved by the NCUA in writing or has been determined to be an incidental power of FCUs by written opinion of the NCUA's General Counsel; or
3. The activity has been approved by the Division in writing or has been determined to be an incidental power of WaSCUs by written opinion of the Division.

We strongly encourage credit unions, when applying to the Division for approval of the exercise of an incidental power, to submit a written opinion of knowledgeable counsel that addresses:

- The VALIC test or the test in 12 C.F.R. 721.2; and
- Whether the activity has been permitted as an incidental power for a bank, savings bank or savings and loan association.

WaSCUs using the exceptions in 1, 2 or 3 above should maintain documentation demonstrating compliance with the exception.

Of course, credit unions must use caution in undertaking any new activity to ensure that all related risks are appropriately assessed and mitigated and that the activity is conducted in a safe and sound manner. For the sake of convenience, we have reprinted below the NCUA's discussion of safety and soundness considerations from its amended IP rule.

Opinion index heading: Powers (including parity …)
Opinion index and list descriptor: Credit Unions May Possess Incidental Powers through Two Sources -
1. The State Parity Provision (RCW 31.12.404); and
2. The State Incidental Powers Provision (RCW 31.12.402(23))

NCUA Discussion of Safety and Soundness Considerations

The NCUA Board wants to emphasize that, while the incidental powers rule identifies categories of activities the Board has identified as within a federal credit union's (FCU's) incidental powers under the Federal Credit union Act (FCU Act), an FCU must comply with all applicable legal requirements and give due consideration to safety and soundness concerns before engaging in an incidental powers activity.

To carry out its responsibilities, FCU management must consider whether its policies for new activities are realistic and carefully designed to enable the FCU to serve the interests and needs of the membership. In addition to meeting various legal requirements, many incidental powers activities require management to provide direction and instruction for officers, employees, and committees delegated the responsibility for implementing new activities.

FCU management is responsible for developing proper internal safeguards such as management oversight, internal controls and quality control. FCUs must examine the strategic risk, reputation risk, transaction risk and compliance risk before engaging in a new activity. In addition, management must exercise due diligence before devoting resources to a new activity or entering into any arrangements with third parties. Activities that involve the use of new technologies must rely on acceptable information systems and operations architecture. FCUs capable of providing advanced technological services must employ appropriate internal controls to minimize technological and legal risk and to address safety and soundness considerations. FCUs must also adjust their risk management process and insurance coverage to correlate with additional risk taken on by engaging in new activities.

NCUA has published guidance papers to assist FCUs in evaluating the risks and understanding the legal requirements involved in some of these activities. This guidance includes:

- NCUA Letter to Credit Unions No. 01-CU-02 (February 2001), offering guidance on the privacy of consumer financial information
- NCUA Letter to Credit Unions No. 109 (September 1, 1989), discussing risks associated with certain computer operations
- NCUA Letter to Credit Unions No. 97-CU-5, addressing electronic financial services
- NCUA Letter to Credit Unions No. 00-CU-11, regarding risk management of outsourced technology services
- NCUA Interpretive Ruling and Policy Statement 85-1, covering trustees and custodians of pension plans.

NCUA's published guidance, along with NCUA's regulations, are available from the agency's website at www.ncua.gov. The Board also recommends that FCUs review interpretive letters and guidance issued by other federal financial institution regulators for assistance in understanding an activity's risks, for example, OCC Bulletin 2001-12 on bank-provided account aggregation services and OCC Advisory Letter 2000-9 on third-party risk. Depending on the activities an FCU undertakes, it may also need to consult with its own legal counsel and other professional advisers.