

# Rules and Regulations

Federal Register

Vol. 68, No. 83

Wednesday, April 30, 2003

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## NATIONAL CREDIT UNION ADMINISTRATION

### 12 CFR Part 701

#### Organization and Operations of Federal Credit Unions

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Final rule.

**SUMMARY:** NCUA is amending its rule that permits a federal credit union (FCU) to provide reasonable retirement benefits to its employees and officers. The amendments clarify the scope of the rule and the investments an FCU may use to fund employee benefits.

**DATES:** This final rule is effective May 30, 2003.

**FOR FURTHER INFORMATION CONTACT:** Frank Kressman, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518-6540.

#### SUPPLEMENTARY INFORMATION:

##### A. Background

NCUA issued a proposed rule in December 2001 to clarify that the scope of § 701.19, which states an FCU may provide reasonable retirement benefits for its employees and officers, is not limited only to retirement benefits, but is more broadly applicable to other employee benefit plans. 66 FR 65662 (December 20, 2001). The proposal incorporated into § 701.19 a number of opinions issued by NCUA's Office of General Counsel that provide an FCU may purchase an otherwise impermissible investment to fund an employee benefit obligation if the investment is directly related to the obligation, and may hold the investment for as long as it has an actual or potential obligation. This direct relationship requirement is the legal basis on which NCUA permits FCUs to make otherwise impermissible investments to fund employee benefits.

NCUA received fifteen comments to the proposal. The comments were generally supportive, but raised investment issues relating to particular benefit plans.

NCUA issued a second proposal in September 2002 to address these issues and others raised outside of the rulemaking process. 67 FR 60184 (September 25, 2002). The second proposal distinguished defined contribution plans from various kinds of defined benefit plans. In the second proposal, NCUA was particularly concerned about FCUs investing to fund defined benefit plans as these plans place investment performance risk on FCUs and make it more difficult for FCUs to demonstrate a direct relationship between an investment and the obligation it serves to fund.

NCUA distinguished defined benefit plans covered by the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 (ERISA) from those that are not. 29 U.S.C. 1101-14. NCUA determined that the ERISA requirements, which provide for a trust and place obligations on the trustee to act prudently on behalf of plan participants and beneficiaries, would safeguard against the legal and safety and soundness risks about which NCUA is concerned. For defined benefit plans not covered by ERISA's fiduciary responsibility provisions, NCUA proposed that investments to fund these plans must have a fixed rate of return, mature on or before the date of the employee benefit obligation, and be rated by a nationally recognized statistical rating organization in one of the four highest rating categories. NCUA believed that these broad criteria would support the determination that an investment is directly related to the employee benefit it is intended to fund and, in addition, address the safety and soundness concerns presented by these otherwise unrestricted investments.

NCUA extended the expiration of the comment period from November 25, 2002 to December 26, 2002. 67 FR 71113 (November 29, 2002).

##### B. Summary of Comments to the Second Proposed Rule

NCUA received twenty-six comment letters regarding the second proposed rule: nine from FCUs, one from a state credit union, thirteen from credit union trade organizations, one from an insurance company, one from a

corporate credit union and one from a law firm. Five commenters expressed complete support for the proposal and did not object to any provisions. All but a few of the remaining commenters expressed general support for NCUA's intent to provide flexibility to FCUs investing to fund employee benefits. Commenters focused primarily on two aspects of the second proposed rule: the requirement that any investments purchased under this authority must be directly related to an FCU's obligation to fund employee benefits and the particular requirements proposed for defined benefit plans.

*Directly Related Requirement.* Some commenters stated that the requirement that an investment to fund an employee benefit be directly related to the FCU's obligation is new or would be too restrictive for certain employee benefit plans. This requirement was stated in the first proposal as well as the second proposed rule. While the particular terminology may be different, this requirement is not new for FCUs. As noted previously, this provision incorporates into the regulation NCUA's long standing position as reflected in legal opinions issued by NCUA's Office of General Counsel.

These legal opinions state NCUA's view that FCUs have the authority to purchase investments otherwise impermissible under the Federal Credit Union Act and NCUA's regulations if the investments are intended to fund an employee benefit. This requisite relationship is the legal basis, as has been previously discussed, which permits these investments. These legal opinions have addressed specific proposed retirement or benefit plans, for the most part defined contribution plans, and have focused on various criteria such as the reasonableness of the benefit in relation to the credit union's size and financial condition. In addition, these letters have noted that the ability of an FCU to make these otherwise impermissible investments is based on the legal premise that an FCU is not investing for its own account and is subject to restriction, such as the investments may only be held for as long as an FCU has an obligation under the retirement or benefit plan. For this reason, NCUA has declined to adopt alternative language proposed by a couple of commenters that an investment need only be reasonably