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#### SUPPLEMENTARY INFORMATION:

##### A. New Sections 701.20 and 741.221—Suretyship and Guaranty

The NCUA Board proposes adding a new § 701.20 to recognize that an FCU, as part of its incidental powers, may act as a guarantor or surety on behalf of a member. 12 U.S.C. 1757(17). Acting as a guarantor or surety on behalf of an FCU member meets the definition of an incidental power because it: Is convenient or useful to an FCU in extending credit to its members; is a logical extension of an FCU's authority to make loans to its members and to provide letters of credit on behalf of members; and involves risks that are similar in nature to the risks involved in an FCU's lending activity. 12 CFR 721.2.

The proposal notes that it does not apply to the guaranty of public deposits or the assumption of liability to pay member accounts. The FCU Act provides express authority for an FCU to guaranty public deposits. 12 U.S.C. 1767(b). The requirements governing the assumption of liability to pay member accounts are in the FCU Act. 12 U.S.C. 1757(b)(1)(B) and (3). Since an FCU may already engage in these activities under the authority and requirements in the FCU Act, it is not necessary to include these activities as part of this rulemaking.

The proposal defines suretyship, guaranty agreements and principal. While both a surety and a guarantor agree to be bound for the principal, there are distinctions. A principal is the "person primarily liable, for whose performance of his obligation the guaranty or surety has become bound." *Blacks Law Dictionary* 1193 (6th ed. 1990). Under a suretyship agreement, a surety is bound with its principal to pay or perform an obligation to a third party. *Id.* at 1441-42. Under a guaranty agreement, on the other hand, the guarantor agrees to satisfy the obligation of the principal to another only if the principal fails to perform. *Id.* at 705. In addition, while a surety is usually bound with the principal by the same instrument, which is executed simultaneously by both the surety and the principal, a guarantor usually enters into a separate agreement with the third party, which the principal does not join. *Id.* at 1441-42. A guaranty agreement is usually entered into before or after that of principal and is often founded on a separate consideration from that supporting the contract of the principal. *Id.*

The proposal includes three requirements designed to ensure the

safety and soundness of surety and guaranty agreements. The Board has the same safety and soundness concerns for FISCUs authorized under state law to enter into surety and guaranty agreements as it does for FCUs. Accordingly, the Board proposes to apply the requirements to FISCUs through new § 741.220. The requirements are modeled after the requirements in the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) rules on guaranty and suretyship. 12 CFR 7.1017 and 560.60.

The first two requirements are substantially similar to the requirements in the OTS rule. The first requires that the obligation under the agreement be limited to a fixed amount and limited in duration. Without a requirement to limit the amount and duration of the agreement, an FCU may take on more risk than it anticipated in the agreement.

The second provision requires that an FCU's performance under the agreement create a loan that is permissible under applicable law because the nature of a surety or guaranty agreement is a loan. The FCU is lending its credit and, in effect, is lending to its member. An FCU may not use a surety or guaranty agreement as a mechanism to avoid the applicable regulatory requirements for loans. These regulatory requirements are in place to ensure the safety and soundness of the transactions. For example, if an FCU will be a surety or guarantor for a member's obligation for a business loan, it must comply with the member business loan requirements. 12 CFR part 723.

This provision also highlights that an FCU must treat its obligation under the agreement as a contractual commitment to advance funds to the principal under the loans-to-one-borrower limits and loans to insider restrictions. 12 CFR 560.60(b)(3), 701.21(c)(5), (d) and 723.8. Again, these requirements are in place to ensure the safety and soundness of the transaction and should not be circumvented through the use of a surety or guaranty agreement.

The third provision addresses collateral requirements and parallels requirements in the OCC and OTS rules. Depending on the nature of the collateral, an FCU must have collateral equal to 100 or 110 percent of the obligation. The 100 percent collateral category includes cash, obligations of the United States or its agencies, obligations fully guaranteed by the United States or its agencies as to principal and interest, and notes, drafts, bills of exchange, and bankers' acceptances that are eligible for rediscount or purchase by a Federal

Reserve Bank. Because the value of some of these types of collateral can fluctuate, the proposal requires that the collateral have a market value at the close of each business day equal to 100 percent of the FCU's total potential liability.

The 110 percent collateral category includes real estate and marketable securities. If the collateral is real estate, an FCU must establish the value of the collateral by an evaluation or appraisal of the real estate consistent with NCUA's appraisal regulation. 12 CFR 722.3. If the collateral is marketable securities, an FCU must be authorized to invest in the securities and must ensure that the value of the securities is equal to 110 percent of the obligation at all times. To protect against risk of loss, an FCU must perfect its security interest in the collateral.

##### B. Section 741.2—Maximum Borrowing Authority

The NCUA Board proposes to amend § 741.2 to create a waiver process for FISCUs that want to exceed the general borrowing limitations in this section provided certain requirements have been met. The FCU Act limits an FCU's maximum borrowing authority to "50 per centum of its paid-in and unimpaired capital and surplus." 12 U.S.C. 1757(9). In 1971, shortly after the passage of Title II of the FCU Act, which authorized the NCUA to provide share insurance, the Board issued regulations governing various aspects of the share insurance program. In particular, the Board, noting that some states had no limitations on borrowing, issued a regulation that made it a requirement for share insurance that all federally insured credit unions comply with the FCU Act's borrowing limitations. 36 FR 10844, June 4, 1971.

While safety and soundness concerns could potentially exist with an FISCU borrowing over the statutory limit for an FCU absent necessary safeguards to ensure due diligence by the FISCU and State and Federal supervisory review, the Board recognizes that it may be appropriate in certain circumstances and on a case-by-case basis to allow an FISCU to exceed the statutory limitation currently imposed on FCUs. The Board proposes allowing an FISCU to apply for a waiver from § 741.2 up to the amount permitted under State law or by the State regulator. Prerequisites for a waiver request include that appropriate safeguards must be in place and that either State law permits the higher limit than that specified in the FCU Act for which the FISCU seeks approval, which is verified by the State regulator, or the State regulator has duly approved a