

BEFORE THE DEPARTMENT OF ADMINISTRATION  
OF THE STATE OF MONTANA

In the matter of the adoption of New Rule I pertaining to credit union supervisory committee, New Rules II through VI pertaining to credit union investment rules, and New Rule VII pertaining to board of director training	)	NOTICE OF PROPOSED ADOPTION
	)	NO PUBLIC HEARING CONTEMPLATED

TO: All Concerned Persons

1. On November 30, 2015, the Department of Administration proposes to adopt the above-stated rules.

2. The Department of Administration will make reasonable accommodations for persons with disabilities who wish to participate in this rulemaking process or need an alternative accessible format of this notice. If you require an accommodation, contact the Department of Administration no later than 5:00 p.m. on November 16, 2015, to advise us of the nature of the accommodation that you need. Please contact Wayne Johnston, Division of Banking and Financial Institutions, P.O. Box 200546, Helena, Montana 59620-0546; telephone (406) 841-2918; TDD (406) 841-2974; facsimile (406) 841-2930; or e-mail banking@mt.gov.

3. The rules as proposed to be adopted provide as follows:

NEW RULE I DUTIES OF THE SUPERVISORY COMMITTEE (1) The supervisory committee shall:

- (a) verify that adequate internal controls are established and maintained to safeguard the credit union's assets;
- (b) oversee the inspection of securities, cash, and accounts of the credit union;
- (c) review credit union operations and monitor its overall financial condition on an ongoing basis;
- (d) review the actions of the board of directors, officers, and committees to ensure that the individuals and entities:
  - (i) exercise firm control over the credit union's affairs;
  - (ii) understand their role; and
  - (iii) promote the credit union for its intended purposes;
- (e) ensure that the credit union complies with all applicable laws and regulations;
- (f) review all new policies and changes to credit union procedures and assess their effects on the safety of members' funds; and
- (g) understand, support, and monitor compliance programs related to the Bank Secrecy Act of 1970 and the Money Laundering Control Act of 1986.

AUTH: 32-3-403, MCA

IMP: 32-3-403, MCA

STATEMENT OF REASONABLE NECESSITY: HB 550, enacted by the 64th Legislature of the state of Montana, amended 32-3-403, MCA, to require rulemaking to establish the duties and powers of a credit union supervisory committee. Therefore, this rule is necessary to establish the duties and powers of a supervisory committee. The rule outlines the primary duties of the supervisory committee. These specific areas were determined by the department to be appropriate for a supervisory committee as opposed to another committee or the board of directors of the credit union. Supervisory committee members have been confused in the past regarding their specific role in the credit union. This rule is designed to allay that confusion by specifically setting forth the supervisory committee duties and responsibilities. The duties listed in this proposed rule came from a variety of industry resources, but most heavily lean on the National Credit Union Administration handbook and the Credit Union National Association handbook.

NEW RULE II NET WORTH DEFINITION – CALCULATION – DETERMINATION (1) For purposes of [New Rules III and IV], "net worth" means the sum of regular reserves, undivided earnings, and membership shares. Net worth excludes the allowance for loan and lease losses. Net worth is calculated quarterly based on data from the previous call report.

(2) The department shall determine compliance with these rules using quarterly net worth for the period in which the security is purchased.

(3) A security that complies with [New Rules III and IV] at the time of purchase is not in violation of [New Rules III and IV] at a later date due to a subsequent decline in net worth.

AUTH: 32-3-701, MCA

IMP: 32-3-701, MCA

STATEMENT OF REASONABLE NECESSITY: It is necessary to define the term "net worth" because it is used in New Rules III and IV. Those rules contain a limit on the amount of securities an institution can purchase expressed as a certain percentage of the net worth of the institution. Those limitations are in place to control the investment risk an institution can acquire. The rules are identical to the rules for state-chartered banks except that banks are limited to a percentage of capital and surplus. Credit unions, as member-owned cooperatives, don't have capital because they don't have stock, so it is necessary to define the equivalent of capital and surplus for credit unions. The department initially considered defining net worth as regular reserves but determined that was too restrictive. After review of several National Credit Union Administration definitions of net worth and capital in different contexts, and discussions with the Credit Union bureau chief, the department determined it appropriate to define net worth as in New Rule II.

NEW RULE III INVESTMENT RULE – CERTAIN QUASI-GOVERNMENT SECURITIES (1) Certain other securities are approved for credit union investment. There is no dollar limit on a credit union's investment in:

- (a) General Services Administration (participation certificates);
  - (b) Maritime Administration (bonds and notes); and
  - (c) Washington Metropolitan Area Transit Authority (bonds).
- (2) A credit union's investment is limited to 50 percent of its net worth in:
- (a) Asian Development Bank (bonds and notes);
  - (b) Financing Corporation (FICO) (bonds);
  - (c) Inter-American Development Bank (bonds);
  - (d) Resolution Funding Corporation (REFCORP) (bonds);
  - (e) Tennessee Valley Authority (TVA) (bonds); and
  - (f) World Bank (bonds and notes).

AUTH: 32-3-701, MCA

IMP: 32-3-701, MCA

STATEMENT OF REASONABLE NECESSITY FOR NEW RULES III, IV, AND V: HB 550, enacted by the 64th Legislature, amended 32-3-701, MCA, to require rulemaking to establish the investment securities that a credit union may hold. Therefore, New Rules III, IV, and V are necessary to establish the investment securities that a credit union may hold. New Rules III, IV, and V list the types of investment securities that are considered appropriate for a credit union to hold. The department selected these types of securities because they are generally considered to be relatively secure investments. Obviously, the statutes and the department do not allow credit unions or other financial institutions to invest in high-risk instruments due to the potential for loss of the investment principal. So these investments, while not generating the highest return, are generally considered to have less risk of loss of the investment principal. These rules include the same other quasi-government securities banks are allowed to invest in (ARM 2.59.1602), corporate bonds banks can invest in (ARM 2.59.1604), and mutual funds banks can invest in (ARM 2.59.1605). The department believes if the investments are appropriate for banks, they are equally appropriate for credit unions.

NEW RULE IV INVESTMENT RULE – CORPORATE BONDS (1) A credit union may invest up to 20 percent of its net worth, per issuer, in corporate bonds.

(2) These bonds must be investment grade, i.e., rated in one of the four highest grades by a recognized national investment rating organization.

(3) Other rating services may be used if the gradations are equivalent to those above, and the rating services are identified by the credit union's investment policy.

(4) Corporate bonds must be reviewed as necessary to assure the credit union's board of directors that bond quality has not fallen below investment grade.

AUTH: 32-3-701, MCA

IMP: 32-3-701, MCA

STATEMENT OF REASONABLE NECESSITY: To invest in corporate bonds, the credit union's investment policy must identify which rating organizations and gradations the credit union will use and that the investments in corporate bonds

must be reviewed in the time frame established by the board to verify the bonds have not fallen below investment grade. This is identical to the bank rule and ensures the credit union identifies the risk it will take based on its policy and continues to monitor its portfolio to confirm that the risk profile of the portfolio has not changed over time.

NEW RULE V INVESTMENT RULE – MUTUAL FUNDS (1) Under the authority of 32-3-701, MCA, and subject to its restrictions, a credit union may invest in mutual funds whose shares represent only those United States obligations listed in [New Rule III].

(2) Shareholders must have a proportionate undivided interest in any mutual fund utilized under this rule.

(3) Shareholders must be shielded from personal liability for acts or obligations of the mutual fund.

(4) The credit union's investment policy, as formally approved by its board of directors, must specifically provide for such investments. Prior approval of the board of directors must be obtained for initial investments in specific mutual funds and recorded in the official board minutes. Procedures, standards, and controls for managing such investments must be implemented prior to the investment being made.

AUTH: 32-3-701, MCA

IMP: 32-3-701, MCA

STATEMENT OF REASONABLE NECESSITY: To invest in mutual funds holding quasi-governmental securities, the credit union's investment policy must allow the investment and contain procedures, standards, and controls for managing the funds before the investment is made. The board of directors must specifically approve the initial investment in the mutual fund. These controls are designed to ensure the board of directors of the credit union specifically understands, reviews, and accepts the risk it is taking in the initial purchase of the security and has a program in place to continue to monitor that risk. This rule is adapted from ARM 2.59.1605, which is the bank investment standard in mutual funds. Shareholders must have a proportionate undivided interest in any mutual fund utilized under this rule because it spreads the risk of the investments held by the mutual fund uniformly over all the participants in the fund. This is a method of limiting risk to each individual participant in the fund. The shareholders must be shielded from personal liability for acts or obligations of the mutual fund so that the credit union is not sued for an action or obligation of the mutual fund. Both of the provisions are designed to limit risk to the credit union.

NEW RULE VI GENERAL OBLIGATION BONDS (1) A credit union may invest, without dollar limitation, in the general obligations of:

(a) any state of the United States if the obligations are fully guaranteed as to the repayment of principal and interest. Evidence of a full guarantee includes, but is not limited to, the pledge of the full faith and credit of the state responsible for repayment of the general obligation; and

- (b) any Montana political subdivision if:
- (i) the obligations are issued pursuant to the Constitution, statute, or the charter or ordinances of the respective county or city;
  - (ii) the obligations are fully guaranteed as to the repayment of principal and interest. Evidence of a full guarantee includes, but is not limited to, the pledge of the full faith and credit of the Montana political subdivision responsible for repayment of the general obligation; and
  - (iii) the issuing body has not been in default regarding the payment of principal or interest on any of its obligations within five years preceding the date of the investment.

AUTH: 32-3-701, MCA

IMP: 32-3-701, MCA

STATEMENT OF REASONABLE NECESSITY: This rule is identical to ARM 2.59.1603, the general obligation investment rule for banks. Because credit unions do not have capital to absorb losses as banks do, it is important to limit the risk that credit unions are allowed to undertake in their investment portfolios. Since credit unions are allowed to invest in general obligations of the state and its subdivisions, those obligations must be backed by the full faith and credit of the state or its political subdivision to ensure the credit union will not lose money on its investment. In addition, it is too risky for credit unions to invest in a general obligation bond of any political subdivision that has defaulted on its obligations in the past five years. Five years was chosen because it is long enough to ensure that the state or its subdivision is financially able to repay its debt, thus limiting risk to the credit union but not so long as to be economically punitive. It is also consistent with the bank rule which also sets a five-year time frame for entities that have defaulted on their obligations. Therefore, the department by this rule seeks to ensure, as much as possible, that credit unions are making safe investment choices.

NEW RULE VII DIRECTOR TRAINING (1) Training topics and course selection for directors' training must reflect the size and complexity of the business model of the credit union that the directors serve and the depth of understanding needed by the directors to effectively manage the credit union. The training must ensure directors achieve at least the minimum level of competency to enable the directors to exercise appropriate independent business judgment to complement the expertise and business judgment of the credit union's executive officers in matters within the board's authority.

AUTH: 32-3-412, MCA

IMP: 32-3-412, MCA

STATEMENT OF REASONABLE NECESSITY: SB 53, which was passed by the 2015 Montana Legislature, repealed 32-3-412, MCA, and adopted a reorganized and expanded version of that statute. The new law includes director education requirements to ensure that the directors, who collectively, have a different role and function from that of the credit union's executive officers, achieve a level of

competency necessary to fulfill that role and perform that function. A credit union's board members are elected (or temporarily appointed to fill unexpired terms of elected board members) by the credit union's members and are not always or necessarily conversant at the outset with responsibilities of managing a member-owned financial institution. The rule is intended to provide direction and guidance to executive officers of credit unions and their current boards concerning development of director education programs that include minimum standards meeting the legislation's objectives.

4. Concerned persons may submit their data, views, or arguments concerning the proposed action in writing to Kelly O'Sullivan, Legal Counsel, Division of Banking and Financial Institutions, P.O. Box 200546, Helena, Montana 59620-0546; faxed to the office at (406) 841-2930; or e-mailed to [banking@mt.gov](mailto:banking@mt.gov); and must be received no later than 5:00 p.m., November 23, 2015.

5. If persons who are directly affected by the proposed action wish to express their data, views, or arguments orally or in writing at a public hearing, they must make written request for a hearing and submit this request along with any written comments to the person listed in 4 above no later than 5:00 p.m., November 16, 2015.

6. If the Division of Banking and Financial Institutions receives requests for a public hearing on the proposed action from either 10 percent or 25, whichever is less, of the persons directly affected by the proposed action; from the appropriate administrative rule review committee of the Legislature; from a governmental subdivision or agency; or from an association having not less than 25 members who will be directly affected, a hearing will be held at a later date. Notice of the hearing will be published in the Montana Administrative Register. Ten percent of those directly affected has been determined to be one person based on the eight state-chartered credit unions.

7. An electronic copy of this proposal notice is available through the department's web site at <http://doa.mt.gov/administrativerules>. The department strives to make the electronic copy of the notice conform to the official version of the notice, as printed in the Montana Administrative Register, but advises all concerned persons that if a discrepancy exists between the official printed text of the notice and the electronic version of the notice, only the official printed text will be considered. In addition, although the department works to keep its web site accessible at all times, concerned persons should be aware that the web site may be unavailable during some periods, due to system maintenance or technical problems.

8. The Division of Banking and Financial Institutions maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this division. Persons who wish to have their name added to the mailing list shall make a written request which includes the name, mailing address, and e-mail address of the person to receive notices and specifies that the person wishes to receive notices regarding division rulemaking actions. Notices will be sent by e-mail

unless a mailing preference is noted in the request. Such written requests may be mailed or delivered to Wayne Johnston, Division of Banking and Financial Institutions, 301 S. Park, Ste. 316, P.O. Box 200546, Helena, Montana 59620-0546; faxed to the office at (406) 841-2930; e-mailed to [banking@mt.gov](mailto:banking@mt.gov); or may be made by completing a request form at any rules hearing held by the department.

9. The bill sponsor contact requirements of 2-4-302, MCA, apply and have been complied with. The bill sponsors were notified by mail on August 6 and August 19, 2015.

10. The department has determined that under 2-4-111, MCA, the adoption of the above-stated rules will not significantly and directly affect small businesses.

By: /s/ Sheila Hogan  
Sheila Hogan, Director  
Department of Administration

By: /s/ Michael P. Manion  
Michael P. Manion, Rule Reviewer  
Department of Administration

Certified to the Secretary of State October 5, 2015