DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

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Safe and Sound Implementation of the Low-Income Designation

The Division of Credit Unions has received inquiries about how a Washington state chartered credit union can obtain a low-income designation. The low-income designation provides expanded authority for the purpose of helping a credit union with its products, services, and loans to low-income individuals and small businesses.

The main focus of this Bulletin is to address the safety and soundness aspects of implementing the expanded authority that comes with a low-income designation, and what conditions examiners expect to find for a low-income credit union (LICU) to be considered safe and sound. Before addressing the safety and soundness aspects of the expanded authority, it is important to discuss the following:

1. What are the state and federal LICU regulations;
2. How to determine whether a credit union would qualify for a low-income designation, and how to apply for it;
3. What expanded authority is given with the low-income designation; and
4. What examiners will expect from a LICU using the expanded authorities

<u>State and Federal Regulations</u>

A Washington state chartered credit union may apply for a low-income designation using one of two options:

1. You may apply for the state LICU authority in RCW 31.12.413, or

2. You may apply for the federal LICU authority using RCW 31.12.404 (federal parity) and 12 C.F.R. 701.34 (federal low-income designation).

The following discussion provides information about using federal parity. The Washington legislature granted state credit unions, among other powers, all the powers and authorities possessed by federal credit unions (FCU powers) as of July 22, 2001 (RCW 31.12.404).

In general, a state credit union may exercise FCU powers as of July 22, 2001, even if other provisions of state law (e.g., other sections of Chapter 31.12 RCW) provide to the contrary. The effect here is as if the FCU powers are written into Chapter 31.12 (Washington Credit Union Act). The state regulator may approve an application for a state credit union to receive a FCU power, such as the federal LICU designation, pursuant to RCW 31.12.404.

When exercising a FCU power, a state credit union must also comply with the restrictions under the National Credit Union Administration's (NCUA) FCU rules that specifically apply to the exercise of that power. These FCU restrictions only apply by virtue of the parity provision, if the state credit union is exercising the FCU power. Consequently, if a state credit union intends to use a FCU power, it should understand the restrictions that go with it.

How to Determine Whether a Credit Union Qualifies for the Low-income Designation & How to Apply for It

If a credit union is interested in applying for a low-income designation, it should first notify the Division of Credit Unions (DCU) of its intent to apply and whether its application will be for the state or federal low-income designation. The next step is to determine if the credit union qualifies for a low-income designation from an analysis of its membership data. To qualify for a low-income designation, a majority of a credit union's membership must meet low-income thresholds based on 2010 Census data.

In February 2013, the National Association of State Credit Union Supervisors (NASCUS) and the National Credit Union Administration (NCUA) established a joint plan to streamline the process for state chartered credit unions to determine if they are eligible for the low-income designation. The easiest method for requesting that a data analysis be performed is for the credit union to contact the NCUA Office of Consumer Protection and then forward the following to it:

1. An Aires Download containing each active member's address, and
2. An excel spreadsheet with the following five pieces of information in their own separate columns; unique ID number, address, city, state, and zip code

This data should be sent via a secured e-mail to the NCUA Office of Consumer Protection at dcamail@ncua.gov. The NCUA Office of Consumer Protection will compare the zip codes of the credit union's membership against the census bureau zip code data (median household income) to determine whether the credit union qualifies for the low-income designation.

The Northwest Credit Union Association provided the following best practices[1] for data submission:

1. Ensure closed accounts are excluded and ensure the number of records closely agrees with the number of members reported on the 5300 Call Report;
2. Provide the member's physical address versus a P.O. Box, or obtain a physical address from the member, if possible before emailing the file;
3. Only include a member once, regardless of how many share type accounts he or she has. It is okay for more than one member to have the same address; and
4. If joint owners are also members, the joint owner's address should be included.

A credit union that receives notification that it qualifies for the low-income designation should make direct application to the Director of the Division of Credit Unions and include a copy of the data analysis performed by NCUA. The DCU will process the application, and if approved, notify the NCUA Office of Consumer Protection that the credit union was approved for either the state low-income designation or the federal low-income designation.

What if Your Credit Union Does Not Qualify?

If the initial data analysis does not meet the qualification requirements and the credit union believes it qualifies for the low-income designation, it may submit additional information to the NCUA Office of Consumer Protection to demonstrate it would qualify. For example, the credit union may want to identify members who are college students; perform a 100% loan review; perform a 100% membership survey; perform a combination loan and survey as long no member is included more than once; or perform a statistically valid sample. Before performing any alternative data analysis, the credit union should contact the NCUA Office of Consumer Protection to ensure the method will be acceptable for qualification purposes. The telephone number for the NCUA Office of Consumer Protection is (703) 518-1150.

Expanded Authority for a LID Credit Union

For the purpose of providing general guidance, the state and federal low-income designation's expanded authorities are summarized in this section. However, each credit union is advised to obtain legal advice on the differences between the state and federal low-income designations and to determine which designation best fits the credit union's business model.

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[1] "NCUA, NASCUS Partner in State-Chartered Low-Income Initiative", by John Trull, NWCUA Anthem, February 21,2013, http://www.nwcua.org/member-resources/anthem/ncua-nascus-partner-in-state-chartered-low-income-initiative

Designation as a low-income credit union brings with it the following potential benefits:

1. The ability to accept deposits from nonmembers
2. The availability of secondary capital accounts
3. An exemption from the aggregate loan limit for member business loans
4. The availability of funds from the federal Community Development Revolving Loan Fund (CDRLF).

Federally insured credit unions must meet the federal requirements for low-income status in order to accept nonmember deposits (other than of public funds, which can be accepted without the designation) *and* accept secondary capital accounts.

Requirements for Low-Income Designation

Federal: In order to qualify for designation as a low-income credit union by the NCUA, a majority of the credit union's members must be "low-income" members. Members are "low-income" if their income or their family's income is 80% or less of the median income of either the metropolitan area in which they live or the national median income for metropolitan areas (whichever is greater). If they don't live in a metropolitan area, their income or their family's income must be 80% or less of the state median income for non-metropolitan areas or the national median income for non-metropolitan areas (whichever is greater).

State: In order to qualify for designation as a low-income credit union under Washington law, a majority of "a substantial and well-defined segment of the members or potential primary members" of a credit union must have income of 80% or less of the state or national median (whichever is greater). The credit union must submit a well-written plan on marketing and serving this low-income segment, and submit annual reports on its service to this segment. Federally insured credit unions must meet the federal requirements in order to accept nonmember, non-federal-public-funds deposits and to accept secondary capital accounts.

Acceptance of Nonmember Deposits

A low-income credit union (LICU) may accept nonmember deposits, in addition to deposits from other credit unions and public funds as limited in RCW 39.58.240(1). Federally insured credit unions must meet the NCUA requirements for low-income status. Federally insured credit unions also are subject to a limit on public unit and nonmember shares of $3 million or 20% of the total shares of the credit union (whichever is greater). Exemptions from these limits are available for credit unions that submit written requests that include a sound plan for the use of the nonmember share funds and copies of financial and policy statements. The exemptions last two years and are presumptively granted where the financial condition and management of the credit union are sound and the plan for the use of the funds is reasonable.

Issuance of Secondary Capital Accounts

A LICU may issue secondary capital accounts. Federally insured credit unions must meet the NCUA requirements for low-income status. Secondary capital accounts must be non-transactional deposit accounts with minimum maturities of five years. The depositors of these accounts are subordinate to other creditors of the credit union (including the owners of share accounts). Part of the funds from these secondary capital accounts can be counted as net worth of the credit union (a decreasing percentage as the accounts' maturity dates approach). They are therefore available to boost the capital ratio of the credit union. The intent is to give the credit union some relief while, ideally, the credit union boosts its primary capital before the maturity of the secondary capital account. Under Washington law, secondary capital accounts must be a minimum of $100,000. For federally insured institutions, the accounts must be available to cover realized losses that exceed the credit union's net available reserves. Federally insured credit unions also cannot take a security interest in secondary capital accounts. Before issuing secondary capital accounts, federally insured credit unions must adopt a secondary capital plan, identifying among other things how the funds will be used and demonstrating how the credit union will provide for liquidity to repay the secondary capital when the account matures. The plan must be submitted to the NCUA for acceptance. Banks are given incentives to lend secondary capital to low-income credit unions, and these institutions, along with federal programs and charitable organizations, are the largest lenders of secondary capital.

Other Benefits

Credit unions that are designated as low-income are exempt from the aggregate loan limit on member business loans under both Washington and federal law. Federally insured credit unions that meet the NCUA requirements for low-income status may also qualify for loans and grants from the Community Development Revolving Loan Fund. This fund, created in 1979, is intended to serve as a source of financial support, in the form of both loans and technical assistance grants, for low-income credit unions.

Examination of a LICU

The Division of Credit Unions (DCU) believes that the additional powers granted to a LICU will help it better meet the financial needs of the members it serves. However, with the additional powers comes an additional responsibility to ensure that a credit union is using its expanded authority in a prudent and safe and sound manner. Examiners will analyze a LICU's use of its expanded authority.

DCU requests that if a credit union decides to take advantage of these exceptions and expanded powers that it prepare and submit to DCU an Expanded Authority Plan that outlines what expanded authorities the credit union plans to use. Specifically, the following will be of primary interest to DCU management and examiners regarding the Expanded Authority Plan:

1. Will the credit union seek grant funding? If so, how will grant funding impact the credit union's operations going forward? Does the LICU plan on receiving grants as a normal course of business to fund operations going forward? Does the credit union plan on applying for the Community Development Financial Institution (CDFI) certification to become eligible for additional financial assistance?
2. Does the credit union plan to accept non-member shares[2] from sources beyond other credit unions and public units? If so, how will this impact the LICU's balance sheet, key financial ratios, and how will the credit union best utilize these deposits to benefit its financial operations? Before accepting any public unit or nonmember shares in excess of 20% of total shares, the LICU must receive approval of its plan from both the state regulator and NCUA. See 12 C.F.R. 741.204 and 701.32(2).
3. What is the credit union's plan on increasing its aggregate level of MBLs? Does it plan to go above the aggregate MBL limit of the lesser of 12.25 percent of total assets or 1.75 times net worth (WAC 204-460-130)? If so, what strategic action plans has the credit union made or will implement to strengthen its commercial lending function and to reduce potential risk in the MBL area? If DCU determines that an LICU doesn't have the ability to originate and manage an MBL portfolio in a safe and sound manner under the LICU, then DCU will place appropriate restrictions (limits) on the credit union's MBL program.
4. Does the credit union plan to raise secondary capital? If so, has the credit union reviewed the secondary capital requirements (i.e. analyzed the required elements of a secondary capital plan) and determined how the credit union will pay back the secondary capital?

The examiners will closely analyze the risk management sections of the Expanded Authority Plan.

Conclusion

This Bulletin is meant to provide general guidance only.

If you have questions about the low-income designation or this Bulletin, please contact Doug Lacy-Roberts, Program Manager of the Division of Credit Unions, at Doug.Lacy-Roberts@dfi.wa.gov or (360) 902-8753.

[2] Shares are defined as regular shares, share certificates, and share draft accounts.