

**STATE OF MINNESOTA  
Department of Commerce**

**In the Matter of the Proposed  
Adoption of Rules Relating  
To Credit Unions**

**STATEMENT OF NEED  
AND REASONABLENESS  
OF PROPOSED RULES**

**STATEMENT OF AUTHORITY**

Minnesota Statutes section 46.01 subdivision 2 authorizes the Commissioner of Commerce ["Commissioner"] to adopt rules as necessary to administer or execute the laws relating to financial institutions subject to the Commissioner's supervision or examination. Credit unions are subject to the Commissioner's supervision or examination pursuant to the provisions of Minnesota Statutes chapter 52.

The rules referred to under the caption above are proposed pursuant to the authority granted to the Commissioner under Minnesota Statutes section 46.01 subdivision 2, and Minnesota Statutes section 45.023.

**FACTS ESTABLISHING NEED AND REASONABLENESS**

Minnesota Rules under chapter 2675 relating to the operation of credit unions are being modified, deleted and promulgated in recognition of changes in the way credit unions do business. The changes are reflective of changes in both federal and state laws that impact accounting standards and documentation necessary to properly operate federally insured depository institutions. The proposed rule revisions are a product of consultation between Commerce Department staff and representatives of the credit union industry, trade associations and the credit union advisory task force.

The Credit Union task force appointed by Commerce Commissioner Bert McKasy first met to discuss proposed rulemaking in October of 1992. Alice Svingel, Board member of the Minnesota Telco Employees Credit Union was appointed by the task force to coordinate discussion on the development of rules with the Commerce Department. Other members of the task force working on rule development included: Simon Hellerman, President of Melrose Credit Union, Linda Romine, President Local I.B.E.W. Credit Union, John Karschnia, CEO United BN Credit Union, and Dick Prevost, CEO Cloquet Coop Credit Union. Working with the task force was Deno Howard, attorney for the Minnesota League of Credit Unions. The task force met with department staff members, and engaged in telephone conferences both among themselves and with Commerce staff.

Copies of the draft rules in their various stages of development and of the proposed final rules were provided to members of the task force and other interested parties. Comments and recommendations from these members and outside parties were reviewed and considered in detail; the final proposed rules incorporate the input of the task force and other interested parties.

The primary reason for the proposed revision to credit union rules began with a request by representatives of the credit union industry to modify Minnesota Rule Part 2675.6141 pertaining to Real Estate Mortgages. The Tax Reform Act of 1986 eliminated from tax deduction most debt interest on consumer transactions, with a major exception being debt interest on loans secured by residential real estate. This exemption created a demand by consumers to have residential real estate encumbered, which is a significant departure from previous practices when the consumer tended to avoid additional encumbrances on residential real estate.

The existing Minnesota Rule Part 2675.6141 established specific documentation requirements for all real estate secured loans except those loans of \$7,500 or less. Real estate secured loans over \$7,500 required the credit union to satisfy documentation requirements, and these related costs were often passed on to the borrowing member.

The proposed amendment to this section provides flexibility by eliminating specific and detailed required procedures in the rules and by permitting credit union boards to adopt prudent but flexible policies where home equity loans secured by real estate could be accepted without obtaining all of the documentation generally required when making purchased money real estate secured loans. The proposed rules still foster necessary safety and soundness considerations while allowing credit unions more control over the highly competitive cost of credit and while satisfying member demands.

As the task force worked to draft changes to Part 2675.6141 to coordinate with federal law, additional rule amendments were discussed and are now being proposed to facilitate more efficient loan and general administration practices while retaining safety and soundness considerations. These amendments are discussed more fully below.

## **MINNESOTA RULE PART 2675.6100 BOOKS, RECORDS, AND REPORTS**

Subpart 5b. Inactive Accounts. This subpart provides that inactive accounts, as determined by a credit union board, need not be issued a statement more frequently than annually if the inactive account is segregated. Credit unions report that their computer systems have a difficult time segregating inactive accounts and to accommodate this requirement would be cost intensive. The modification to the rule deletes the segregated requirement and substitutes identification of the inactive account "by code or some other means". The basic intent of the rule remains unchanged.

Subpart 6. Issuing Account Numbers. This subpart is modified to provide that member account numbers need not be issued in one sequential order. The proposed revision permits credit unions that have branch offices the capability of identifying member account numbers sequentially within the office where the member conducts the majority of business. In requiring account numbers to be issued in a predetermined pattern, a suffix or prefix could be added to identify a member by branch without affecting this critical audit control.

## **MINNESOTA RULE PART 2675.6120 OTHER REAL ESTATE**

Subpart 1. Transfers. This subpart relates to the timing of the transfer of real estate secured loans from Loans to Other Real Estate in the credit union's chart of accounts. The date of sheriff's certificate, quit claim, or other deed now becomes the effective date of transfer, rather than the previous language which referenced the date the credit union actually acquired title. Foreclosed real estate is often subject to a redemption period. During this period, a non-earning asset is held and cannot be sold with good title even though it is technically owned by the Credit Union. Transferring this asset from their Loan account to their Other Real Estate account presents a more accurate portrayal of the credit unions' assets. The date of transfer will differ from the date at which write down occurs. This inconsistency was discussed with the advisory task force and they determined that this inconsistency was not a problem.

Subpart 6. Unsold Other Real Estate. This subpart is restated to establish the basis in time for the write down on other real estate as the end of any redemption period rather than the date of sheriff's sale or the date booked as other real estate. Credit unions argued against the requirement of having to begin a systematic write down prior to obtaining fee title on other real estate. The argument is reasonable and the proposed rules state the systematic write down will begin at the expiration of any redemption period following foreclosure or upon obtaining a deed in lieu of foreclosure. Credit unions are not required to reestablish market value by formal appraisal on foreclosed real property, thus the annual write down requirement helps to ensure that credit union assets will not be carried at inflated amounts.

## **MINNESOTA RULE PART 2675.6141 REAL ESTATE MORTGAGES**

Specific real estate loan documentation requirements under subparts 2,3,4 and 6 under Part 2675.6141 have been deleted for the reasons discussed earlier in this document and following. Proposed Minnesota Rule Part 2675.6141, Subpart 1a requires each credit union board to adopt a written loan policy addressing real estate loan documentation requirements. The revised rule makes reference to minimum documentation provisions to be included in board policy and permits the filing of a lien on real property as a precaution against contingencies. This rule ensures maintenance of underwriting standards while providing credit unions the flexibility to take on credit risk commensurate with each credit union's financial strength. Some members of the credit union task force committee supported deleting minimum documentation provisions entirely. However, where it is reasonable to take collateral it is necessary to establish a reliable value of that collateral to the credit union. This is best accomplished by established industry documentation procedures. An "Owners and Encumbrance Report", available through title insurance companies, has been added as an option to title insurance or attorneys opinion, in cases where there is low credit risk, as a means to safely reduce costs for some of the members.

Existing Minnesota Rule Part 2675.6141, Subpart 5, regarding fees on real estate loans has been relocated to Minnesota Rule Part 2675.6142 Loans.

## **MINNESOTA RULE 2675.6142 LOANS**

This Part has been rewritten for clarity and flexibility while ensuring credit union board involvement in developing underwriting standards for safe and sound credit union operations.

Subpart 1. Fees. Proposed Subpart 1 authorizes loan fees as specified by an individual credit union's board by resolution. Minnesota Statutes, Section 52.141 permits a credit union to charge loan expenses and authorizes the commissioner to prescribe by rule which expenses are allowable and their amount. In reality, credit unions are cooperatives which should be responsible for setting fees subject to review by the membership. The proposed rule permits each credit union, through its elected board, to establish loan fees by formal board resolution. A provision to the proposed rule requiring disclosure of fees was deleted at the request of the credit union advisory task force members who argued that any fees assessed would already be covered by federal disclosure requirements at the time of the loan and additional disclosure requirements could be duplicative and confusing.

However, under the rule as proposed, it is the fee setting authority that will be at the discretion of each credit union's board of directors by formal board requirements. The proposed rule requires the board resolution establishing fees to be conspicuously posted at the credit union's principal office as a means of providing a source for members to review fees assessed as a matter of credit union policy and to make this important information available without attending board meetings or searching board minutes.

Subpart 1a. Other Charges. The provisions under the proposed subpart 1a are identical to the provisions under subpart 1c of the current rules, Part 2675.6142. Only the placement and title of these provisions is changed.

Subpart 2. This subpart which specifies financial statement requirements for loans has been repealed and replaced by subpart 3 which now requires a "financial review" of various classes of loans as specified by board policy which is to be reviewed and approved annually by the board. This amendment coincides with the overall purpose of the changes being proposed to chapter 2675, as discussed previously in this document. The new provisions provide greater flexibility for each credit union board to control its operations, while still maintaining safety and soundness considerations.

Subpart 3. Written Policy. This subpart requires a written loan policy approved annually by each credit union board which specifies financial review requirements. The substituted language is needed for safety and soundness but is written to provide flexibility to fit the diversity of a credit union's membership, size and financial strength. One single list of loan file requirements to measure credit capacity and collateral is not feasible as credit unions develop more diverse lending products. Each credit union will be expected to keep fully informed on the financial condition of their borrowing members.

## **MINNESOTA RULE PART 2675.6143 DELINQUENT LOANS**

Subpart 4. Delinquent Loan Report. This subpart has been reworded to make delinquent loan review by the board less onerous. It is impossible to expect such a high level of familiarity with each credit as the existing rule implies. Boards exercise oversight responsibilities and rely on credit committees and credit managers to provide detail and critical information. Each board will now be required to develop a program to ensure that it is kept fully informed on the status of delinquent loans and monthly collection actions.

Subpart 5. This subpart has been repealed to delete the antiquated loan loss reserve test. The proposed revision, identified as Subpart 5a. Loan Reserve Requirements and Dividends, is in keeping with generally accepted accounting principles and the federal insurance of accounts agreement. An Allowance for Loan Loss Account must now be established based on an objective assessment of risk within the loan portfolio taking into consideration various risk elements not only contractual payment delinquency as in the old system. This account must be fully funded at the time dividends are declared to fairly present the credit union's financial condition. Should net income be deficient to pay dividends after funding the allowance account, prompt notice to the Commissioner is required. This is necessary to carry out effective supervision of credit unions. Beginning in December 1991 the National Credit Union Administration which insures all of Minnesota's credit unions moved away from statutory reserve and into establishing an Allowance for Loan Loss Account based on individual loans or class of loans criticized. The rule change compliments the NCUA's position and the position taken with other financial institutions in Minnesota since the mid 1980's. Each institution is expected to risk rate its loans to confirm reserve adequacy. This will identify remaining statutory reserves in credit unions as part of equity capital.

#### **MINNESOTA RULE PART 2675.6200 LOAN CHARGES**

This part is repealed as such charges are now established by the board in the procedure described in Minnesota Rule 2675.6142, Subpart 1.

#### **MINNESOTA RULE PART 2675.6250 FIDELITY BONDS**

Subpart 3. Minimum Provisions. This subpart is modified to delete the board's establishment of minimum amounts of bond coverage and maximum deductible amounts as this is dictated by federal insurance of accounts agreement.

#### **MINNESOTA RULE 2675.6260 DELINQUENT LOANS**

This section is repealed as a housekeeping item. It is no longer applicable and was inadvertently left in active rules after the 1985 revisions.

#### **MINNESOTA RULE PART 2675.6301 CERTIFIED PUBLIC ACCOUNTANT REPORT IN LIEU OF EXAMINATION**

This Part has been repealed as the statutory authority has been rescinded.

#### **SMALL BUSINESS CONSIDERATIONS**

Credit unions are member owned cooperatives and as such do not, for the most part, fit the definition of "Small Business" under Minnesota Statutes, Section 14.115 subdivision 1. Even if there are small businesses that would be affected by the proposed rules, the proposed rules are housekeeping by nature and provide less rather than more restrictions. Nevertheless, the impact on small businesses has been considered at every stage of the rulemaking process. It is expected that the impact of the proposed rules on such businesses will be a positive one.

- a) Less stringent compliance or reporting requirements.

The proposed rules permit greater flexibility to credit unions in documenting real estate loans and provide for the exclusion of documentation where a loan fits a "precaution against contingency" definition. Dormant accounts, if identified as such, do not have to be segregated to qualify for issuing a statement less than annually. These requirements will apply to both large and small credit unions. Since the overall purpose of the rules is to protect shareholders and the solvency of the regulated entities, any less stringent reporting and compliance requirements for small businesses would be at odds with the purposes and intent of the rules and enabling statute.

- b) Less stringent schedules or deadlines for compliance.

The proposed rules would require the credit union to provide notification when dividends are not paid from current earnings rather than obtaining permission before payment. The notification process cannot be reduced any further for small businesses without compromising the protection intended by the statute and rules.

- c) Consolidation or simplification of compliance or reporting requirements.

Delinquent loan review by the board has been made less onerous and permits each individual credit union board to develop their own preferred method. The proposed rules provide that statutory write down on other real estate begins from the time the credit union acquired control and title. No further consolidation or simplification of compliance or reporting requirements are deemed advisable for small businesses affected by the proposed rules. To do so could jeopardize the protection to shareholders and to the solvency of the regulated entities.

- d) Establishment of performance standards to replace design or operational standards required in the rule.

The proposed rules eliminate the statutory reserve test in Minnesota Rule, Part 2675.6143, Subpart 5, leaving the requirement for financial review and/or financial statements up to the discretion of each credit union board by its policy development. This will maximize the ability of small businesses to establish standards that best fit their needs. No further accommodation to small business is deemed to be necessary.

- e) Exemption of small businesses from any or all requirements of the rule.


Since the purpose of the rules is to protect shareholders and the solvency of the regulated companies, exclusion of small business from any part of the proposed rules would be at odds with the purposes and intent of the rules and enabling statute.

Small business participation in rulemaking:

Proposed rules have been developed through dialogue with the Credit Union Advisory Task Force. In addition to the notice of solicitation of outside opinion and comments with respect to the intent to promulgate rules, all credit unions and the two Minnesota trade associations have been provided with copies of the proposed rules and invited to comment thereon.

For the reasons set forth above, the proposed rules relating to credit unions have been determined to be needed and reasonable.

8/27/93  
Date

  
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Patrick L. Nelson  
Commissioner of Commerce (Acting)



OFFICE OF THE COMMISSIONER

# STATE OF MINNESOTA

DEPARTMENT OF COMMERCE

133 EAST 7th STREET  
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August 27, 1993

Legislative Commission to Review Administrative Rules  
55 State Office Building  
100 Constitution Avenue  
St. Paul, MN 55155  
ATTN: Michelle

Re: Proposed Rules Relating to Credit Unions

Dear Michelle:

Pursuant to Minnesota Statutes Section §14.23 we enclose a copy of the Statement of Need and Reasonableness for the proposed rules relating to Credit Unions.

Should you have any questions about these rules, please call me at 297-1118.

Sincerely,

PATRICK L. NELSON  
Commissioner of Commerce (Acting)

By:

A handwritten signature in cursive script that reads "Donna M. Watz".

Donna M. Watz  
Staff Attorney

DMW:joc