



## ***CREDIT UNION DEPARTMENT***

**DATE:** July 23, 2012

**TO:** State Chartered Credit Unions

**SUBJECT:** Change 32 to Update the Texas Rules for Credit Unions

The attached pages constitute changes to the Texas Rules for Credit Unions. Your book of rules should be updated as follows:

<b><u>REMOVE PAGES</u></b>	<b><u>INSERT</u></b>	<b><u>AMENDMENTS OR NEW RULES</u></b>
91-59 thru 91-62	91-59 thru 91-62	Amended Rule 91.801
91-70-a thru 91-70-b	91-70-a thru 91-70-b	Amended Rule 91.808
91-95 thru 91-98	91-95 thru 91-98	Readopted Rule 91.7000 with no changes
91-99 thru 91-102	91-99 thru 91-102	Readopted Rule 91.800 with no changes
Regulatory Bulletins Table of Contents	Regulatory Bulletins Table of Contents	
N/A	Regulatory Bulletin Pages 122 thru 125	Add New Bulletins (RB 2012-01 and RB 2012-02)

**FOR YOUR RECORDS** - Please keep this letter of transmittal behind the **Update Tab** of the Rules Section of your binder as a record to show your rules are up to date.

## Subchapter H. Investments

### §91.801. Investments in Credit Union Service Organizations.

(a) Definitions. As used in this section:

(1) A credit union service organization (CUSO) is an organization whose primary purpose is to strengthen or advance the credit union movement, serve or otherwise assist credit unions or their operations, and provide products or services authorized by this section to credit unions and their members.

(2) An investment in a CUSO includes the following:

(A) an investment in the stock, bonds, debentures, or other equity ownership interest of the CUSO; and

(B) loans granted by a third party to the CUSO which are guaranteed in writing by the credit union.

(3) A financing program is a plan, approved by the credit union's board of directors, that provides for multiple extensions of credit to a CUSO during the regular course of business.

(b) Authority. A credit union by itself, or with other parties, may organize, invest in or make loans to a CUSO only if it is structured and operated in a manner that demonstrates to the public that it maintains a legal existence separate from the credit union. A credit union and a CUSO must operate so that:

(1) their respective business transactions, accounts, and records are not intermingled;

(2) each observes the formalities of its separate corporate or other organizational procedures;

(3) each is adequately capitalized as a separate unit in light of normal obligations reasonably foreseeable in a business of its size and character;

(4) each is held out to the public as a separate and distinct enterprise;

(5) all transactions between them are at arm's length and consistent with sound business practices as to each of them;

(6) unless the credit union has guaranteed a loan to the CUSO, all borrowings by the CUSO indicate that the credit union is not liable; and

(7) their respective activities are in compliance with any licensing or registration requirements imposed by applicable federal or state law.

(c) Notice; Authorization; Supplemental Information; Written Objection.

(1) Required Notice. Before committing to any aggregate investment or loan to a CUSO in an amount greater than 15% of the credit union's net worth, a credit union shall provide at least thirty days' written notice to the commissioner of its intent to make or increase its investment in a CUSO, or make a loan to or enter into a financing program with a CUSO. Subject to the net worth threshold, a credit union shall also provide notice of its intent to engage in additional or substitute activities in an existing CUSO or its intent to materially alter an existing loan or financing program with a CUSO. The written notice shall include as applicable:

(A) a description of the organizational and legal structure of the CUSO and the proposed method of capitalizing the organization;

(B) a description of the loan, including the purpose, terms, guarantors, and collateral;

(C) a description of the products or services to be offered by the CUSO and the customer base it will serve;

(D) an explanation of how the CUSO will primarily serve credit unions or members of credit unions, or how the activities of the CUSO could be conducted directly by a credit union or are incidental to the conduct of the business of a credit union; and

(E) a representation that the activities will be conducted in accordance with applicable law, the requirements of this section, and in a manner that will limit exposure of the credit union to no more than the loss of funds invested in, or loaned to, the CUSO.

(2) Authorization to Proceed. If the commissioner issues a non-objection letter, the credit union may proceed with the proposed transaction when it receives the letter. Otherwise, a credit union may proceed with the proposed transaction or the CUSO may engage in the new activities 30 days after the department receives the required notice, unless the commissioner takes one of the following actions before the expiration of that time period:

(A) the commissioner notifies the credit union that it must file additional information supplementing the required notice. If a credit union is required to file additional information, it may proceed with the proposed transaction or the CUSO may engage in the new activities 30 days after the department receives the requested information, unless the commissioner issues a written objection before the expiration of that time period; or

(B) the commissioner notifies the credit union of an objection to the proposed transaction or new activity.

(3) Request for Supplemental Information. A credit union shall provide any additional information reasonably requested by the commissioner.

(4) Action on a Notice. The commissioner shall object to a proposed transaction or activity if the commissioner finds that:

(A) there is inadequate capital to support the proposed transaction or activity;

(B) the proposed transaction or activity does not comply with this section;

(C) the credit union's concentrated exposures to the CUSO give rise to safety and soundness issues; or

(D) the credit union has regulatory or operational deficiencies which would materially affect its ability to properly and effectively manage and monitor the risk associated with the CUSO.

(5) Written Objection. If the commissioner determines that an objection should be interposed, the commissioner will notify the credit union in writing of the determination and the actions the credit union must take to proceed with the proposed transaction or activity. A credit union receiving notification of an objection may appeal the commissioner's finding to the commission in the manner provided by Chapter 93, Subchapter C of this title (relating to Appeals of Preliminary Determinations on Applications).

(d) Limitations. The board of directors of a credit union that organizes, invests in, or lends to any CUSO shall adopt and maintain written policies, which establish appropriate limits and standards for this type of investment including the maximum amount relative to the credit union's net worth, that will be invested in or loaned to any one CUSO. The maximum amount invested in any one CUSO may not exceed the statutory limit established by Texas Finance Code §124.352(b). Total investments in and total loans to CUSOs shall not, in the aggregate, exceed 10% of the total unconsolidated assets of the credit union, unless the credit union receives the prior written approval of the commissioner. The amount of loans to CUSOs, cosigned, endorsed, or otherwise guaranteed by the credit union, shall be included in the aggregate for the purpose of determining compliance with the limitations of this section.

(e) Prohibitions. No credit union may invest in or make loans to a CUSO:

(1) if any officer, director, committee member, or employee of the credit union or any member of the immediate family of such persons owns or makes an investment in or has made or makes a loan to the CUSO;

(2) unless the organization is structured as a corporation, limited liability company, registered limited liability partnership, or limited partnership;

(3) unless the credit union has obtained written legal advice that the CUSO has been designed in a manner that will limit the credit union's potential exposure to no more than the amount of funds invested in or loaned to the CUSO;

(4) if the CUSO engages in any revenue-producing activity other than the performance of services for credit unions or members of credit unions, and such activity equals or exceeds one half (1/2) of the CUSO's total revenue;

(5) unless prior to investing in or making a loan to a CUSO the credit union obtains a written agreement which requires the CUSO to follow GAAP, render financial statements to the credit union at least quarterly, and provide the department, or its representatives, complete access to the CUSO's books and records at reasonable times without undue interference with the business affairs of the CUSO;

(6) unless the CUSO is adequately bonded or insured for its operations;

(7) unless the CUSO obtains an annual opinion audit, by a licensed Certified Public Accountant, on its financial statements in accordance with generally accepted auditing standards, unless the investment in or loan to the CUSO by any one or more credit unions does not exceed \$100,000, or the CUSO is wholly owned and the CUSO is included in the annual consolidated financial statement audit of its parent credit union; or

(8) if any director of the credit union is an employee of the CUSO, or anticipates becoming an employee of the CUSO upon its formation.

(f) Permissible activities and services. The commissioner may, based upon supervisory, legal, or safety and soundness reasons, limit any CUSO activities or services, or refuse to permit any CUSO activities or services. Otherwise, a credit union may invest in or loan to a CUSO that is engaged in providing products and services that include, but are not limited to:

(1) operational services including credit and debit card services, cash services, wire transfers, audits, ATM and other EFT services, share draft and check processing and related services, shared service center operations, electronic data processing, development, sale, lease, or servicing of computer hardware and software, alternative methods of financing and related services, other lending related services, and other services or activity, including consulting, related to the routine daily operations of credit unions;

(2) financial services including financial planning and counseling, securities brokerage and dealer activities, estate planning, tax services, insurance services, administering retirement, or deferred compensation and other employee or business benefit plans;

(3) internet-based or related services including sale and delivery of products to credit unions or members of credit unions; or

(4) any other product, service or activity deemed economically beneficial or attractive to credit unions or credit union members if approved, in writing, by the commissioner.

(g) Compensation. A credit union director, senior management employee, or committee member or immediate family member of any such person may not receive any salary, commission, or other income or compensation, either directly or indirectly, from a CUSO affiliated with their credit union, unless received in accordance with a written agreement between the CUSO and the credit union. The agreement shall describe the services to be performed, the rate of compensation (or a description of the method of determining the amount of compensation) and any other provisions deemed desirable by the CUSO and the credit union. The agreement, and any amendments, must be approved by the board of directors of the credit union and the board of directors (or equivalent governing body) of the CUSO prior to any performance of service or payment and annually thereafter. For purposes of this section, senior management employee shall include the chief executive officer, any assistant chief executive

officers (vice presidents and above), and the chief financial officer. Immediate family shall include a person's spouse or any other person living in the same household.

(h) Examination fee. If the commissioner requests a CUSO to make its books and records available for inspection and examination, the CUSO shall pay a supplemental examination fee as prescribed in §97.113(e) of this title (relating to Supplemental examination fees). The commissioner may waive the supplemental examination fee or reduce the fee.

(i) Exception. A credit union which has a net worth ratio greater than six percent (6%) and is deemed adequately capitalized by its insuring organization may make an investment in or make loans to a CUSO that is not limited by the restriction set forth in subsection (e)(4) of this section, provided the activities of the CUSO are limited to activities which could be conducted directly by a credit union or are incidental to the conduct of the business of a credit union. Notwithstanding this exception, all other provisions of the act and this chapter applicable to a CUSO apply. In the event a credit union's net worth declines below the required thresholds, the credit union may not renew, extend the maturity of, or restructure an existing loan, advance additional funds, or increase the investment in the CUSO without the prior written approval of the commissioner.

(j) Change in Valuation. If the limitations established by this section are reached or exceeded solely because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method, divestiture is not required. A credit union may continue to invest up to the limitation without regard to the increase in the GAAP valuation resulting from a CUSO's profitability.

*Source: The provisions of this §91.801 adopted to be effective August 14, 2000, 25 TexReg 7635; adopted to be effective January 7, 2004, 29 TexReg 83; amended to be effective July 11, 2004, 29 TexReg 6630; amended to be effective July 10, 2005, 30 TexReg 3863; amended to be effective November 11, 2007, 32 TexReg 7921; amended to be effective March 4, 2009, 34 TexReg 1400; reviewed and amended to be effective March 8, 2012, 37 TexReg 1506; amended to be effective June 18, 2012, 37, TexReg 4410.*

## **§91.802. Other Investments.**

(a) Definitions. Unless the context clearly indicates otherwise, these words and terms, when used in this section, shall have the following meanings.

(1) Asset-backed security--A bond, note, or other obligation issued by a financial institution, trust, insurance company, or other corporation secured by either a pool of loans, extensions of credit which are unsecured or secured by personal property, or a pool of personal property leases.

(2) Bailment for hire contract--A contract whereby a third party, bank, or other financial institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers; also known as a custodial agreement.

(3) Bankers' acceptance--A time draft that is drawn on and accepted by a bank, and that represents an irrevocable obligation of the bank.

(4) Cash forward agreement--An agreement to purchase or sell a security with delivery and acceptance being mandatory and at a future date in excess of 30 days from the trade date.

(5) Counterparty--An entity with which a credit union conducts investment-related activities in such a manner as to create a credit risk exposure for the credit union to the entity.

(6) Eurodollar deposit--A deposit denominated in U. S. dollars in a foreign branch of a United States financial institution.

(7) Federal funds transaction--A short-term or open-ended transfer of funds to a financial institution.

(3) uses the same underwriting standards for loan participation investments as it does for loans originated by the credit union; and

(4) limits its aggregate investment in loan participation investments to an amount no greater than 50% of the credit union's net worth.

(b) Financial Reporting. A participation interest in a non-member loan purchased under this section shall be reported in accordance with generally accepted accounting principles.

(c) Other Requirements. A credit union purchasing a loan participation investment must also comply with applicable requirements contained within Part 741 of the National Credit Union Administration Rules and Regulations.

*Source: The provisions of this §91.805 adopted to be effective August 14, 2000, 25 TexReg 7636; readopted to be effective February 24, 2004, 29 TexReg 2393; amended to be effective November 11, 2007, 32 TexReg 7923; reviewed and amended to be effective November 13, 2011, 36 TexReg 7544.*

### **§91.808. Reporting Investment Activities to the Board of Directors.**

(a) A credit union shall provide its board of directors a monthly comprehensive report of investment activities, including:

(1) investments purchased and sold during the month;

(2) unrealized market gains or losses compared to book value for each security at month's end;

(3) fair or market value of each security;

(4) total book value of investments outstanding at month's end;

(5) unrecorded and unreported obligations to buy or sell investments; and

(6) amount of investments, other than deposits and investments in designated depositories, that are not either issued by, or fully guaranteed as to principal and interest by, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the United States or any agency, enterprise, corporation, or instrumentality of the United States, or in any trust or trusts established for investing, directly or collectively, in such securities, obligations or instruments.

(b) The credit union shall also provide a quarterly report to the board of directors that summarizes the volatility of the entire security portfolio, if the aggregate amount of securities with one or more of the features included below exceeds the credit union's net worth:

(1) embedded options;

(2) remaining maturities greater than three years; or

(3) coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.

(c) The report described in subsection (b) of this section must provide a reasonable and supportable estimate of the potential impact, in percentage and dollar terms, of an immediate and sustained parallel shift in market interest rates of plus and minus 300 basis points on the:

(1) fair value of each security in the entire portfolio;

(2) fair value of the entire security portfolio as a whole; and

(3) credit union's net worth.

(d) For the purposes of this section, an embedded option means a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. Embedded options include call and put provisions and interest rate caps and floors. Since a prepayment option in a mortgage is a type of call provision, a mortgage-backed security composed of mortgages that may be prepaid is an example of an investment with an embedded option.

*Source: The provisions of this §91.808 adopted to be effective February 11, 2001, 26 TexReg 1137; readopted to be effective February 24, 2004, 29 TexReg 2393; amended to be effective November 11, 2007, 32 TexReg 7923; reviewed and readopted to be effective June 20, 2011, 36 TexReg 4152; amended to be effective July 8, 2012; 37 TexReg 4888.*

## Subchapter P. Other Forms of Equity Capital

### §91.7000. Certificates of Indebtedness.

(a) General. No credit union may issue certificates of indebtedness pursuant to this section or amend the terms of such certificates unless it has obtained a written letter from the commissioner stating that the commissioner does not object (“non-objection letter”). All requirements of the provisions of this section must be met before a non-objection letter will be issued.

(b) Form of application; supporting information. Applications must be in the form prescribed by the commissioner and shall include all information and exhibits required by the application instructions.

(c) Requirements as to certificates. Certificates of Indebtedness issued pursuant to this section shall meet all of the following requirements:

(1) Form of certificate. Each certificate evidencing subordinated debt issued by a credit union pursuant to this section shall:

(A) Bear on its face, in bold-face type, the following legends:

(i) “This certificate is not a share account or deposit and it is not insured by the United States or any other insuring organization or fund”; and

(ii) “This certificate is not eligible for purchase by any credit union or a credit union service organization thereof without the prior written approval of the Credit Union Commissioner of the State of Texas.”

(B) Clearly state that the certificate –

(i) Is subordinated to all other claims of the credit union’s creditors;

(ii) Is totally unsecured; and

(iii) May not be used as collateral for any loan by the issuing credit union.

(C) Shall include within its terms the right of the issuing credit union to prepay the obligation, which shall, at a minimum, include the right to prepay any amount without premium or penalty any time during the fifteen months prior to the maturity date;

(D) Shall contain the following statement:

“Notwithstanding anything to the contrary in this certificate (or in any related documents); (i) if the NCUA or other insuring organization shall be appointed liquidating agent for the issuer of this certificate (“the issuer”) and in its capacity as such shall cause the issuer to merge with or into another credit union, or in such capacity shall sell or otherwise convey part or all of the assets of the issuer to another credit union or shall arrange for the assumption of less than all of the liabilities of the issuer by one or more credit unions, the NCUA or other insuring organization shall have no obligation, either in its capacity as liquidating agent or in its corporate capacity, to contract for or to otherwise arrange for the assumption of the obligations represented by this certificate in whole or in part by any credit union or credit unions which results from any such merger or which has purchased or otherwise acquired from the NCUA or other insuring organization as liquidating agent for the issuer, any of the assets of the issuer, or which, pursuant to any arrangement with the NCUA or insuring organization, has assumed less than all of the liabilities of the issuer. To the extent that obligations represented by this certificate have not been assumed in full by a credit union with or into which the issuer may have been merged, as described in this paragraph (A), and/or by one or more credit unions which have succeeded to all or a portion of the assets of the issuer, or which have assumed a portion but not all of the liabilities of the issuer as a result of one or more transactions entered into by the NCUA or other insuring organization as liquidating agent for the issuer, then the holder of this certificate shall be entitled to payments on this obligation in



accordance with the procedures and priorities set forth in any applicable law. (ii) In the event that the obligation represented by this certificate is assumed in full by another credit union, which shall succeed by merger or otherwise to substantially all of the assets and the business of the issuer, or which shall by arrangement with the NCUA or insuring organization assume all or a portion of the liabilities of the issuer, and payment or provision for shall have been made in respect of all matured installments of interests upon the certificates together with all matured installments of principal on such certificates which shall have become due otherwise than by acceleration, than any default caused by the appointment of a liquidating agent for the issuer shall be deemed to have been cured, and any declaration consequent upon such default declaring the principal and interest on the certificate to be immediately due and payable shall be deemed to have been rescinded. (iii) This certificate is not eligible to be purchased or held by any credit union or credit union service organization thereof. The issuer of this certificate may not recognize on its transfer books any transfer made to a credit union or any credit union service organization thereof and will not be obligated to make any payments of principal or interest on this certificate if the owner of this certificate is a credit union or any credit union service organization thereof.”

(2) Limitations as to term and prepayment.

(A) No certificate of indebtedness issued by a credit union pursuant to this section shall have an original period to maturity of less than seven years. During the first six years that such a certificate is outstanding, the total of all required sinking fund payments, other required prepayments, and required reserve allocations with respect to the portion of such six years as have elapsed shall at no time exceed the original principal amount or original redemption price, thereof multiplied by a fraction, the numerator of which is the number of years that have elapsed since the issuance of the certificate and the denominator of which is the number of years covered by the original period to maturity.

(B) No voluntary prepayment of principal shall be made and no payment of principal shall be accelerated without the approval of the commissioner if the credit union’s net worth ratio is below 6% or, if after giving effect to such payment, the credit union’s net worth ratio would fall below 6%.

(d) Offering circular. The credit union shall submit the proposed offering circular to the Department. The offering circular must state the following in bold print:

**“These certificates have not been approved by the Texas Credit Union Department nor has the Texas Credit Union Department approved this offering circular.”**

(e) Supervisory objection. Generally, the commissioner will not issue a non-objection letter where:

(1) The proposed issue fails to transfer risk away from the National Credit Union Share Insurance Fund or other insuring organization and onto the certificate holders.

(2) Information submitted in connection with the application or otherwise available to the Department indicates that the credit union will not be able to service the proposed debt. Evaluation of the issuer’s ability to service debt should be prospective, based upon the issuer’s business plan.

(3) The ratio of subordinated debt included as equity capital to the credit union’s net worth requirements exceeds one-third, after giving effect to the proposed issue.

(4) The proposed deployment of the proceeds of the proposed issue is contrary to the credit union’s business plan, is unrealistic in its assumptions, or is inconsistent with the principles of safety and soundness.

(5) The credit union has failed to comply with the terms and conditions imposed upon previous subordinated debt issuances, or has failed to comply with any outstanding enforcement action, written agreement or any other significant supervisory requirement.

(f) Additional requirements. The commissioner may impose on the credit union such requirements or conditions with regard to certificates or the offering or issuance thereof as the commissioner may deem necessary or desirable for the protection of purchasers, the credit union, the National Credit Union Share Insurance Fund, or other insuring organization, as the case may be.

(g) Limitation on offering period. Following the date of the issuance of a non-objection letter, the credit union shall have an offering period of not more than one year in which to complete the sale of the certificates of indebtedness issued pursuant to this section. The commissioner may in his discretion extend such offering period if a written request showing good cause for such extension is filed with the Department not later than 30 days before the expiration of such offering period or any previous extension thereof.

(h) Policies and Procedures. Before any offers or sales of the certificates are made on the premises of the credit union or its credit union service organization, the credit union shall submit to the Department a set of policies and procedures for such sale of certificates that is satisfactory to the Department.

(i) Records. A credit union shall establish and maintain certificate of indebtedness documentation practices and records that demonstrate the credit union appropriately administers and monitors certificate of indebtedness-related activities. The credit union's records should adequately evidence ownership, balances, and all transactions involving each certificate. The credit union may maintain records on certificate of indebtedness activities in any format that is consistent with standard business practices.

(j) Disclosures.

(1) In connection with the purchase of a certificate of indebtedness by a person from the issuing credit union or its credit union service organization, the credit union and/or the credit union service organization must disclose to the person that:

(A) The certificate of indebtedness is not a share or deposit;

(B) The certificate of indebtedness is not insured by the National Credit Union Share Insurance Fund or any other insuring organization;

(C) There is investment risk associated with the certificate of indebtedness, including the possible loss of value; and

(D) The credit union may not condition an extension of credit on a person's purchase of a certificate of indebtedness.

(2) The disclosures required by paragraph (1) above must be provided orally and in writing before the completion of the sale of a certificate of indebtedness. If the sale of a certificate of indebtedness is conducted by telephone, the credit union may provide the written disclosure required by paragraph (1) by mail within three business days beginning the first business day after the sale, solicitation, or offer.

(3) A credit union may provide the written disclosures required by paragraph (1) through electronic media instead of on paper, if the person affirmatively consents to receiving the disclosures electronically and if the disclosures are provided in a format that the person may retain or obtain later, for example, by printing or storing electronically (such as by downloading).

(4) The disclosures provided shall be conspicuous and designed to call attention to the nature and significance of the information provided.

(k) Sales Activities. A credit union must, to the extent practicable:

(1) Keep the area where the credit union conducts transactions involving certificate of indebtedness physically segregated from areas where shares and deposits are routinely accepted from members;

(2) Identify the area where certificate of indebtedness activities occur; and

(3) Clearly delineate and distinguish those areas from the areas where the credit union's share- and deposit-taking activities occur.

(l) Referrals. Any person who accepts deposits from members in an area where such transactions are routinely conducted in a credit union may refer a member who seeks to purchase a certificate of indebtedness to a qualified person who sells that product only if the person making the referral receives no additional compensation for making the referral.

(m) Reports. Within 30 days after completion of the sale of the subordinated debt issued pursuant to this section, the credit union shall transmit a written report to the Department stating the number of purchases, the total dollar amount of certificates sold, and the amount of net proceeds received by the credit union. The credit union's report shall clearly state the amount of subordinated debt, net of all expenses that the credit union intends to have counted as equity capital. In addition, the credit union, shall submit to the Department, certification of compliance with all applicable laws and regulations in connection with the offering, issuance, and sale of the certificates.

(n) Equity capital. When a certificate of indebtedness has a remaining maturity of 5 years, the amount of the certificates that may be considered equity capital shall be reduced by a minimum of 20% of the original amount of the certificate per year. The equity capital shall be reduced by a constant monthly amortization to ensure the recognition of subordinated debt is fully amortized when the certificate matures or is prepaid.

(o) Prohibited practices.

(1) A credit union may not engage in any practice or use any advertisement at any office of, or on behalf of, a credit union that could mislead any person or otherwise cause a reasonable person to reach an erroneous belief with respect to:

(A) the fact that a certificate of indebtedness a credit union sells or offers for sale is not insured by the National Credit Union Share Insurance Fund or other insuring organization;

(B) the fact that there is an investment risk, including the potential that principal may be lost and that the certificate may decline in value; or

(C) the fact that the approval of an extension of credit to a person by the credit union or credit union service organization may not be conditioned on the purchase of a certificate of indebtedness from the credit union or credit union service organization.

(2) No credit union shall directly or indirectly:

(A) employ any device, scheme or artifice to defraud,

(B) make any untrue statement of a material fact or omit to state a material fact necessary in order to make statements made, in light of the circumstances under which they were made, not misleading, or

(C) engage in any act, practice, or course of business which operates as a fraud or deceit upon any person, in connection with the purchase or sale of any certificate of indebtedness.

*Source: The provisions of this §91.7000 adopted to be effective March 14, 2004, 29 TexReg 2638; reviewed and readopted to be effective June 23, 2008, 33 TexReg 5352; reviewed and readopted to be effective July 18, 2012, 37 TexReg 4958.*

## Subchapter Q. Access to Confidential Information

### §91.8000. Discovery of Confidential Information.

(a) Policy. The legislature has determined that certain information is confidential and, with limited exceptions, should not be disclosed. See Texas Finance Code, §126.002. Non-disclosure under this section protects the stability of credit unions by preventing disclosures that could adversely impact the institutions. Inappropriate disclosures can result in substantial harm to credit unions and to those persons and entities (including other financial institutions) that have relationships with them. For example, the department may criticize a credit union in an examination report for a financial weakness that does not currently threaten the solvency of the credit union. If improperly disclosed, the criticism can lead to adverse impacts such as the possibility of a "run," short-term liquidity problems, or volatility in costs of funds, which in turn can exacerbate the problem and cause the failure of the credit union. These failures lead to reduced access to credit and greater risk to depositors. Further, since specific loans may be criticized in an examination report, confidentiality of the information protects the financial privacy of borrowers. Finally, protecting confidential information from disclosure facilitates the free exchange of information between the credit union and the regulator, encourages candor, and promotes regulatory responsiveness and effectiveness. Information that does not fall within the meaning of confidential information as defined in this section may be confidential under other definitions and controlled by other laws, and is not subject to this section.

(b) Disclosure prohibited. Pursuant to Finance Code §126.002, the department has an absolute privilege against disclosure of its confidential information. Discovery of confidential information from a person subject to §126.002 must comply with subsection (c) of this section. Only a person to whom confidential information has been released pursuant to §126.002 or this rule may disclose that information to another, and only in accordance with that section and this rule.

(c) Discovery of confidential information. A credit union, governmental agency, credit union service organization, service provider, or insuring organization that receives a subpoena or other form of discovery for the release of information that is confidential under §126.002 of the Act shall promptly:

- (1) notify the department of the request;
- (2) provide the department with a copy of the discovery documentation and, if requested by the department, a copy of the requested information; and

- (3) move for a protective order, or its equivalent under applicable rules of procedure.

In addition, prior to the release of confidential information, such credit union, governmental agency, credit union service organization, service provider, or insuring organization must obtain a ruling on its motion in accordance with this section. Confidential information may be released only pursuant to a protective order, or its equivalent, in a form consistent with that set out in this section and only if a court with jurisdiction has found that:

- (A) the party seeking the information has a substantial need for the information;

- (B) the information is directly relevant to the legal dispute in issue; and

- (C) the party seeking the information is unable without undue hardship to obtain its substantial equivalent by other means.

(d) Discretionary filings by department. On receipt of notice under subsection (c) of this section, the department may take action as may be appropriate to protect confidential information. The department has standing to intervene in a suit or administrative hearing for the purpose of filing a motion for protective order and in camera inspection in accordance with this section.

(e) Motion for protective order, or equivalent, and in camera inspection. The movant shall ask the court to enter an order in accordance with this section regarding the release of confidential information. If necessary to resolve a dispute regarding the confidential status or direct relevance of any information sought to be released, the party seeking the order shall move for an in camera inspection of the pertinent information. Until subject to a protective order, or its equivalent, confidential information may not be released, and, if necessary, the party seeking an order shall request the court officer to deny discovery of such confidential information.

(f) Protective order or equivalent. An order obtained pursuant to the terms of this section must:

(1) specifically bind each party to the litigation, including one who becomes a party to the suit after the order is entered, each attorney of record, and each person who becomes privy to the confidential information as a result of its disclosure under the terms of the order;

(2) describe in general terms the confidential information to be produced;

(3) state substantially the following in the body of the order:

(A) absent court order to the contrary, only the court reporter and attorneys of record in the cause may copy confidential information produced under the order in whole or part;

(B) the attorneys of record are custodians responsible for all originals and copies of confidential information produced under the order and must insure that disclosure is limited to those persons specified in the order;

(C) confidential information subject to the order and all information derived there from may be used only for the purposes of the trial, appeal, or other proceedings in the case in which it is produced;

(D) confidential information to be filed or included in a filing in the case must be filed with the clerk separately in a sealed envelope bearing suitable identification, and is available only to the court and to those persons authorized by the order to receive confidential information, and all originals and copies made of such documents and records must be kept under seal and disclosed only in accordance with the term of the protective order;

(E) confidential information produced under the order may be disclosed only to the following persons and only after counsel has explained the terms of the order to the person who will receive the information and provided that person with a copy of the order;

(i) to a party and to an officer, employee, or representative of a party, to a party's attorneys (including other members and associates of the respective law firms and contract attorneys in connection with work on the case) and, to the extent an attorney of record in good faith determines disclosure is necessary or appropriate for the conduct of the litigation, legal assistants, office clerks and secretaries working under the attorney's supervision;

(ii) to a witness or potential witness in the case;

(iii) to an outside expert retained for consultation or for testimony, provided the expert agrees to be bound by the terms of the order and the party employing the expert agrees to be responsible for the compliance by its expert with this confidentiality obligation; and

(iv) to the court or to an appellate officer or body with jurisdiction of an appeal in the case;

(F) at the request of the department or a party, only the court, the parties and their attorneys, and other persons the court reasonably determines should be present may attend the live testimony of a witness or discussions or oral arguments before the court that may include confidential information or relate to such confidential information. The parties shall request the court to instruct all persons present at such testimony, discussions, or arguments that release of confidential information is strictly forbidden;

(G) a transcript, including a deposition transcript, that may include confidential information subject to non-disclosure is subject to the order. The party requesting the testimony of a current or former department officer, employee, or agent shall, at its expense, furnish the department a copy of the transcript of the testimony once it has been transcribed.

(H) Upon ultimate conclusion of the case by final judgment and the expiration of time to appeal, or by settlement or otherwise, counsel for each party shall return all copies of every document subject to the order for which the counsel is custodian to the party that produced the confidential information; and

(I) Production of documents subject to the order does not waive a claim of privilege or right to withhold the documents from a person not subject to the order.

(4) Paragraph (3)(A), (B) and (E) - (H) of this subsection are subject to modification by the court for good cause before the conclusion of the proceeding, after giving the department notice and an opportunity to appear.

*Source: The provisions of this §91.8000 adopted to be effective March 14, 2004, 29 TexReg 2638; reviewed and readopted to be effective June 23, 2008, 33 TexReg 5352, amended to be effective July 12, 2009, 34 TexReg 4513; reviewed and readopted to be effective July 18, 2012, 37 TexReg 4958.*

**(THIS PAGE WAS INTENTIONALLY LEFT BLANK)**

# REGULATORY BULLETINS

## TABLE OF CONTENTS

BULLETIN NO.	SUBJECT MATTER	PAGE
RB 1999-01	Guidance on Electronic Financial Services	1
RB 1999-02	Guidance on Loan Participations	9
RB 2000-01	Guidance on Allowance for Loan and Lease Losses <b>(Rescinded – October 2008)</b>	13
RB 2000-02	Guidance on Information System Security	23
RB 2000-03	Guidance on Credit Union Names	31
RB 2000-04	Guidance on Office Closing Notices <b>(Revised – March 2006)</b>	35
RB 2001-01	Guidance on the Civil Asset Forfeiture Statute	39
RB 2001-02	Guidance on Communication with External Auditors	45
RB 2001-03	Guidance on Nondeposit Investment Sales	49
RB 2001-04	Guidance on Loans Secured by Readily Marketable Collateral	57
RB 2002-01	Guidance on Brokered Certificates of Deposit	61
RB 2002-02	Guidance on Internal Controls	65
RB 2002-03	Guidance on Fiduciary Powers/Trust Activities	71
RB 2002-04	Guidance on Board & Directorship Responsibilities <b>(Revised – November 2009)</b>	79
RB 2003-01	Guidance on Servicing Members Affected by Natural Disaster	83
RB 2004-01	Guidance on Annual Audit and Account Verification	85
RB 2005-01	Guidance on Bank Secrecy Act (BSA) Compliance	91
RB 2006-01	Guidance on Management Oversight by the Board of Directors	95
RB 2006-02	Guidance on the Importance of Loan Policies	99
RB 2007-01	Guidance on the New Mortgage Fraud Notice <b>(Rescinded – March 2008)</b>	103
RB 2008-01	Guidance on Advertising	105
RB 2008-02	Guidance for Loan and Lease Losses	107
RB 2009-01	Guidance on Risk Management: Asset Concentrations	111
RB 2009-02	Guidance on Other Real Estate Owned (OREO)	113
RB 2010-01	Guidance on Restrictions Resulting from a Decline in Net Worth	118
RB 2010-02	Guidance on Accounting for Credit Losses	120



# **REGULATORY BULLETINS**

## **TABLE OF CONTENTS**

<b>BULLETIN NO.</b>	<b>SUBJECT MATTER</b>	<b>PAGE</b>
RB 2012-01	Guidance on Department's Examination Standards and Review of Examination Findings	122
RB 2012-02	Guidance on Commercial Mortgage-Related Securities	124

# Texas Credit Union Department

## *REGULATORY BULLETIN*

April 13, 2012

RB 2012-01

## Guidance on Department's Examination Standards and Review of Examination Findings

### **Introduction**

The Department is responsible for fostering the safety and soundness of the Texas credit union system and for monitoring and enforcing credit union compliance with applicable laws and regulations. In fulfilling these responsibilities, the Department strives to maintain open and ongoing communication with the credit unions it supervises. The Department is committed to a supervisory process that is fair and equitable.

### **Supervisory Objectives**

The Department has established the following objectives for its supervisory program:

1. Ensure appropriate controls and management systems are in place to safeguard credit union assets, without attempting to completely eliminate risk.
2. Make sure credit unions act in accordance with applicable laws and regulations.
3. Encourage communication between the Department and credit unions to identify and resolve regulatory concerns.
4. Take fair and consistent administrative actions when necessary, based on facts and regulatory authority that have been clearly communicated to credit union management.
5. Provide credit unions with a review process through the Department's chain of command that credit unions can use without fear of retaliation.

### **Standards of Conduct**

The Department's staff will:

1. Maintain objectivity and independence in the discharge of their professional responsibilities.
2. Maintain the highest standards of integrity in performing their duties.
3. Be available for open dialogue regarding examination findings and the application of applicable laws and regulations.

## **Examination Process**

As part of the Department's examination process:

1. The examiner-in-charge will act as the central point of contact with the credit union.
2. Examiners will provide an independent evaluation of the condition of the credit union, as well as the levels and trends of the risks associated with current and planned activities.
3. Examiners will determine compliance with credit union laws and regulations.
4. Examiners will evaluate the effectiveness of any corrective actions undertaken to resolve regulatory concerns.
5. Examiners will provide an opportunity for the credit union to discuss the basis for the findings, provide additional data, or suggest alternative resolution for any regulatory concerns identified during the exam.
6. Examiners will meet with management prior to concluding the on-site examination to discuss findings, conclusions, and proposed corrective actions.

## **What Credit Unions Should Know**

The credit union and the examiner-in-charge should thoroughly discuss any differences regarding examination findings. If the issues are not resolved at that level, the credit union should request additional involvement by the Field Manager or the Department's Chief Examiner. For differences that exist after the credit union has received the final report of examination, a credit union should submit a written response outlining the basis for its position. In addition, a credit union may request a review and a formal Department response regarding any examination finding. The Department is committed to making every effort to resolve examination disputes fairly, expeditiously, and amicably.

The Department expects its examination staff to interact with credit unions in a professional and fair manner. A credit union that experiences treatment that is not consistent with this standard or the standards addressed in this guidance should discuss their concerns with the Department's Field Manager, Chief Examiner, or Deputy Commissioner.

## **Formal Enforcement-Related Actions**

Once a formal enforcement-related action or decision is issued under applicable statutes or regulations, a credit union may not seek review of examination findings via the informal process outlined above. At that point the action or decision becomes subject to the provisions of Title 7, Chapter 93 of the Texas Administrative Code, and a credit union may proceed with an appeal under that process.

# Texas Credit Union Department

## *REGULATORY BULLETIN*

June 18, 2012

RB 2012-02

## Guidance on Commercial Mortgage-Related Securities

### **Introduction**

Credit unions have long been authorized to invest in mortgage-related securities issued by federal government-sponsored enterprises. Recently a question arose whether this authority includes *commercial* mortgage-related securities issued by a federal government-sponsored enterprise. This Bulletin discusses the authority to invest in certain commercial mortgage-related securities and provides safety and soundness guidelines applicable to these securities.

### **Interpretation**

Generally, 7 TAC Section 91.803 provides that credit unions may not purchase commercial mortgage-related securities. Section 124.351 of the Finance Code and 7 TAC Section 91.802, however, authorize credit unions to invest in securities issued by federal government-sponsored enterprises such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC).

Title 7 TAC Section 91.802(a)(10) incorporates United States Code Annotated, Title 15, Section 78c(a)(41)'s definition of mortgage-related security, which includes securities issued by an entity, *other than* a federal government-sponsored enterprise, backed by mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure. Reconciling the authorization of 7 TAC Section 81.802 with the prohibition in 7 TAC Section 91.803, a credit union is prohibited from purchasing commercial mortgage-related securities of an issuer *other than* a federal government-sponsored enterprise. Conversely, a credit union may purchase a commercial mortgage-related security issued by a federal government-sponsored enterprise.

### **Safety and Soundness Considerations**

While this investment is permitted, it may not be suitable for every credit union. When selecting commercial mortgage-related securities consistent with safety and soundness, credit unions must carefully analyze the underlying commercial mortgages and corresponding collateral, as well as analyzing the cash flow, credit structure, and market performance of the security. As with all investments, credit unions must understand and be capable of managing the risks associated with commercial mortgage-related

securities before purchasing them. 7 TAC Section 91.802 requires a credit union's board of directors to develop investment policies that address credit, liquidity, interest rate, and concentration risks. Policies must also identify investment characteristics that are suitable for the credit union. Credit unions that purchase commercial mortgage-related securities must develop sound risk management policies and construct limits that represent the board's risk tolerance.

## **Conclusions**

Credit unions may invest in commercial mortgage-related securities issued by a federal government-sponsored enterprise but these investments require the same sound investment policies and practices as other investments. In brief, the board of credit unions purchasing commercial mortgage-related securities should:

1. diversify these investments by type, maturity, and degree of risk;
2. follow investment strategy that includes an asset-liability and rate sensitivity analysis;
3. deal with established, financially sound, and reputable broker/dealers;
4. determine that proper safekeeping of securities is maintained; and
5. monitor investments continually, review management performance, and determine compliance with policy.