

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Parts 704 and 713**

**RIN 3133-AE87**

**Fidelity Bonds**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Final rule.

**SUMMARY:** The NCUA Board (Board) is finalizing a rule that amends its regulations regarding fidelity bonds under Part 704 for corporate credit unions and under Part 713 for natural person credit unions. The rule strengthens a board of directors' oversight of a federally insured credit union's (FICU) fidelity bond coverage; ensures an adequate period to discover and file fidelity bond claims following a FICU's liquidation; codifies a 2017 NCUA Office of General Counsel legal opinion that permits a natural person credit union's fidelity bond to include coverage for certain credit union service organizations (CUSOs); and addresses Board approval of bond forms.

**DATES:** The final rule is effective [INSERT DATE 90 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** Rob Robine, Trial Attorney, or Rachel Ackmann, Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314-3428 or telephone (703) 548-2601.

## **SUPPLEMENTARY INFORMATION**

- I. Introduction**
- II. Proposed Rule**
- III. Final Rule and Discussion of Comments**
- IV. Regulatory Procedures**

### **I. Introduction**

#### **a. Background and Legal Authority**

The Federal Credit Union Act (FCU Act) requires that certain credit union employees and appointed and elected officials be subject to fidelity bond coverage.<sup>1</sup> The FCU Act directs the Board to promulgate regulations concerning both the amount and

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<sup>1</sup> 12 U.S.C. 1761a, 1761b, and 1766.

character of fidelity bond coverage and to approve bond forms.<sup>2</sup> The pertinent portion of the FCU Act provides:

The Board is ... directed to require that every person appointed or elected by any Federal credit union to any position requiring the receipt, payment, or custody of money or other personal property owned by a Federal credit union or in its custody or control as collateral or otherwise, give bond in a corporate surety company holding a certificate of authority from the Secretary of Treasury ... as an acceptable surety on Federal bonds. Any such bond or bonds shall be in a form approved by the Board with a view to providing surety coverage to the Federal credit union with reference to loss by reason of acts of fraud or dishonesty including forgery, theft, embezzlement, wrongful abstraction, or misapplication on the part of the person, directly or through connivance with others, and such other surety coverages as the Board may determine to be reasonably appropriate. Any such bond or bonds shall be in such an amount in relation to the ... assets of the Federal credit union as the Board may from time to time prescribe by regulation[.]<sup>3</sup>

Parts 704 and 713 of the NCUA's regulations implement the requirements of the FCU Act regarding fidelity bonds.<sup>4</sup> Part 713 applies to natural person credit unions and Part 704 applies to corporate credit unions. The parts establish the requirements for a fidelity bond, the acceptable bond forms, and the minimum permissible coverage. Both parts require a FICU's board of directors to review annually its fidelity bond coverage to ensure it is adequate in relation to the potential risks facing the FICU and the minimum requirements set by the Board.

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<sup>2</sup> The FCU Act also grants the Board the powers to require such other surety coverage as the Board may determine to be reasonably appropriate; to approve a blanket bond in lieu of individual bonds; and to approve bond coverage in excess of minimum surety coverage.

<sup>3</sup> 12 U.S.C. 1766(h).

<sup>4</sup> 12 CFR pts. 704 and 713.

Part 704 was recently revised to amend the provision that determines the maximum amount a corporate credit union may pay for a deductible or a covered loss before the fidelity bond insurer makes a payment. The NCUA restricts the deductible a corporate credit union may pay to limit the potential losses to it if there is a covered claim. The maximum deductible allowed is a percentage of a corporate credit union's capital based on its leverage ratio. For example, if a corporate credit union has a greater than 2.25 percent leverage ratio then it may have a maximum deductible that is 15 percent of its tier 1 capital. The recent final rule updated this provision to reference tier 1 capital instead of core capital.<sup>5</sup> Part 713, however, has not been substantively revised since 2005, when the NCUA issued a final rule modernizing it.<sup>6</sup>

#### **b. Regulatory Reform Task Force**

In August 2017, the Board published and sought comment on the NCUA's regulatory reform agenda (Agenda).<sup>7</sup> The Agenda identifies those regulations the Board intends to amend or repeal because they are outdated, ineffective, or excessively burdensome. This is consistent with the spirit of Executive Order 13777.<sup>8</sup> Although the NCUA, as an independent agency, is not required to comply with Executive Order 13777, the Board has chosen to comply with it in spirit and has reviewed all of the NCUA's regulations to that end. One of the items in the Agenda is related to the NCUA's regulations on fidelity bonds. The Agenda supports exploring ways to implement the

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<sup>5</sup> 80 FR 25932 (May 6, 2015).

<sup>6</sup> 70 FR 61713 (Oct. 26, 2005). In 2012, the NCUA revised Part 713 by removing reference to the agency's former Regulatory Flexibility Program. 77 FR 74112 (Dec. 13, 2012).

<sup>7</sup> 82 FR 39702 (Aug. 22, 2017).

<sup>8</sup> E.O. 13777 (Feb. 24, 2017).

requirements of the FCU Act related to fidelity bonds in the least costly way possible.

The Agenda further notes that while the FCU Act mandates fidelity bond coverage, the NCUA's objective should be to allow a credit union to make a business decision based on its own circumstances and needs. This would effectively reduce the NCUA's involvement in a credit union's operational decisions while remaining consistent with the FCU Act.

### **c. The 2017 Legal Opinion**

As discussed above, Part 713 establishes the minimum requirements for a fidelity bond for a natural person credit union. One such requirement under Part 713 is that fidelity bonds be purchased in an "individual policy."<sup>9</sup> The "individual policy" provision was intended to prevent multiple FICUs from being insured under one fidelity bond policy. The Board prohibited such joint coverage because the loss suffered by one or two of the joint policyholders could reduce the amount of available coverage for the other policyholders to below the required minimum amount.<sup>10</sup> Before 2017, the NCUA's Office of General Counsel (OGC) had issued legal opinions stating that a FICU may not include one or more CUSOs or other parties as additional insureds under its fidelity bond because of the "individual policy" limitation.<sup>11</sup> It came to OGC's attention, however, that some bond issuers may have been interpreting their policies to permit the issuance of bonds that covered FICUs and their CUSOs, despite OGC's opinions. This prompted

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<sup>9</sup> 12 CFR 713.3(a). There is not an analogous provision for corporate credit unions under Part 704, therefore, the legal opinion relates only to fidelity bonds for natural person FICUs under Part 713.

<sup>10</sup> 64 FR 28178 (May 27, 1999).

<sup>11</sup> OGC Legal Op. 14-0311 (Mar. 21, 2014); see also OGC Legal Op. 04-0744 (Sept. 21, 2004).

OGC to review the regulation and approved bond forms. As a result of that review, OGC issued another legal opinion in September 2017 that rescinded and replaced all previous legal opinions that addressed the “individual policy” requirement.<sup>12</sup> The 2017 opinion concluded that the “individual policy” requirement of § 713.3(a) of the NCUA’s regulations generally prohibits joint coverage under fidelity bonds, but does not prohibit a FICU from purchasing a fidelity bond that covers both it and certain of its CUSOs, as discussed more fully below.

## **II. Proposed Rule**

OGC’s fidelity bond review extended beyond the issue of joint coverage and revealed several inconsistencies between Part 713 and approved bond forms. The review also revealed several outdated provisions. In November 2018, the NCUA published a notice of proposed rulemaking (the proposed rule) to update its fidelity bond regulation to correct these problems, ensure the safe and sound operation of FICUs, and protect the National Credit Union Share Insurance Fund (NCUSIF).<sup>13</sup> The comment period closed on January 22, 2019.

## **III. Final Rule and Discussion of Comments**

**The NCUA received 26 comment letters on its November 2018 proposed rule. These comments were received from credit unions, including corporate credit unions, credit union leagues and trade associations, an association of state credit union**

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<sup>12</sup> OGC Legal Op. 17-0959 (Sept. 26, 2017).

<sup>13</sup> 83 FR 59318 (Nov. 23, 2018).

**supervisors, an insurance company, and two insurance associations. In general, many of the commenters supported the stated goal, to implement fidelity bond requirements in a cost-effective manner. All of the commenters, however, expressed concerns about specific aspects of the proposal. Most commenters believed that the proposed rule resulted in unnecessary burden and increased costs without substantially improving the adequacy of FICU fidelity bond coverage. Some commenters also expressed concerns that the rule reduced the number of insurance companies providing fidelity bonds, which would reduce FICUs' ability to negotiate among providers. In response to the comments received, the Board has made several changes to the final rule. The specific details of the final rule, including changes as a result of the comments received, are discussed below.**

### *Part 713*

In general, Part 713 applies to all federally insured natural person credit unions and provides the fidelity bond requirements for them. Changes to the specific subsections of Part 713 are discussed below.

#### *§ 713.1 What is the scope of this section?*

The proposed rule retained most of the current § 713.1 without change, with the following exceptions. The proposed rule added the words “federally insured” before the words “credit union” to more precisely describe which credit unions are subject to the section. The current rule uses the term “credit union” and “federal credit union” interchangeably to mean “federal credit union.” As discussed in the background section,

the requirements in Part 713 are applicable to both federal credit unions and federally insured, state-chartered credit unions (FISCUs).<sup>14</sup> For clarity, the proposed rule cross-referenced the requirement in Part 741 that FISCUs must comply with Part 713 and referred to FICUs throughout the rule instead of federal credit unions.

One commenter questioned whether the proposed rule should be applicable to all FISCUs. FISCUs' fidelity bond requirements are applied through Part 741, which states that "[a]ny credit union which makes application for insurance . . . must possess the minimum fidelity bond coverage stated in [P]art 713 . . . ." The commenter stated that the positioning of the language referring to minimum coverage means that only the amount of bond coverage, and not the other requirements in Part 713, apply to FISCUs. The commenter stated that the NCUA should invite specific comment on whether all of Part 713 should apply to FISCUs. The commenter also does not believe it is necessary for the NCUA to impose detailed provisions on FISCUs' fidelity bonds.

The Board has considered the comment and disagrees that Part 741 applies to only the amount of bond coverage. Part 741 does not use the term "amount" and instead uses the term "minimum coverage." The Board believes that the reasonable and plain understanding of the term "coverage" includes factors such as the amount of insurance, the claims covered by the insurance, and other operational considerations that ensure the coverage is adequate. The Board's position is further supported by the fact it has been

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<sup>14</sup> Part 713 is applicable to all FISCUs through § 741.201 of the NCUA's regulations, which states that any credit union which makes application for share insurance must have the minimum fidelity bond coverage stated in Part 713 in order for its application to be approved and for such share insurance coverage to continue.

the Board's public and longstanding position that the entirety of Part 713 applies to FISCUs. The commenter even noted that prior NCUA discussions of Part 713 were directed to all FISCUs. Therefore, the Board is finalizing this provision as proposed.

The final rule also includes a cross-reference for corporate credit unions and states that corporate credit unions must comply with § 704.18 instead of Part 713.

*§ 713.2 What are the responsibilities of a federally insured credit union's board of directors under this section?*

*2(a)*

The proposed rule amended current § 713.2 by dividing the section into two subparagraphs. Current § 713.2 became paragraph (a). The proposed rule retained most of the current § 713.2 without change, with the following exception. For consistency with the rest of Part 713, the term "Federal credit union" was revised to "federally insured credit union." The Board did not receive any comment on this provision and is finalizing it as proposed.

*2(b)*

The proposed rule added a new paragraph (b) to § 713.2. Proposed paragraph (b) increased a board of directors' oversight responsibility of its FICU's fidelity bond coverage. Specifically, the proposed rule required a FICU's board, and, if applicable, a FICU's supervisory committee, to review all applications for purchase or renewal of

bond coverage and to pass a board resolution approving the purchase or renewal. The proposed rule also required a FICU's board to delegate one board member, who is not an employee of the FICU, to sign the attestation for bond purchase or renewal. This proposal prohibited the same board member from signing the attestation for renewal in consecutive years.

The Board notes the current rule already requires a FICU's board to annually review its fidelity bond and other insurance coverage to ensure it is adequate. The proposed rule took that review a step further and required a FICU's board, and, if applicable, its supervisory committee, to review all applications for purchase or renewal of fidelity bond coverage. The Board believed this change helped ensure the board is addressing the adequacy of the coverage at all stages, rather than at an annual point in time that may be retrospective, and require additional steps by the FICU to remedy a deficiency.

Almost every commenter objected to the requirement for additional board review and stated that the current requirement for an annual review of the adequacy of coverage is sufficient. Most commenters stated that bond renewal is a highly involved, time-intensive, and technical process and that it is more appropriate for a board of directors to focus on broad strategic goals. One commenter stated that a bond renewal usually takes about one year to complete. A few commenters stated that the risk of loss from dishonest employees is better addressed through NCUA's examination of a credit union's internal

controls. In contrast, one insurance company supported the proposed requirement as adding an important layer of review.

The Board continues to believe that an ongoing review by a FICU's board of directors is necessary to ensure the adequacy of fidelity bond coverage. The Board agrees with commenters that adequate internal controls are a fundamental part of ensuring a FICU's safety and soundness. The Board, however, also believes that adequate fidelity bond coverage complements sound internal controls. Therefore, the Board is finalizing a board's requirement to review all applications for purchase or renewal of fidelity bond coverage as proposed.

The proposed rule required a FICU's supervisory committee to conduct a review of all applications for purchase or renewal of fidelity bond coverage, in addition to the FICU's board. Several commenters objected to the proposed requirement that both the board of directors and the supervisory committee were responsible for reviewing renewal documents. Commenters generally believed that the dual review is unnecessary. A few commenters noted that many supervisory committees do not meet as frequently as boards of directors and it would be very difficult to synchronize their review given the back-and-forth negotiating with the insurance company that usually occurs during the renewal process. After reviewing the comments, the Board has removed the requirement for the supervisory committee to review fidelity bond purchases or renewals. The Board believes that removing the requirement for supervisory committee review balances the

Board's concern for adequate fidelity bond oversight with concerns about regulatory burden.

As noted, the proposed rule also required a FICU's board to, after conducting its review, pass a resolution approving the purchase or renewal of fidelity coverage and designating a member of the board, who is not an employee of the FICU, to sign applications for purchase, bond renewals, and any accompanying attestations. Also as mentioned, the proposed rule required that the member of the board acting as signatory rotate each time the FICU purchases or renews fidelity coverage. Commenters were almost universally against this proposed requirement.

A few commenters stated that some insurance companies require an employee of the credit union to sign the renewal documents. The Board is aware that under the current rule it is industry practice for employees to generally sign renewal documents. The final rule, however, requires that a non-employee sign the renewal documents. This policy may necessitate changes to certain fidelity bond forms.

One commenter thought a more effective solution would be to mandate the inclusion of a clause in the fidelity bond contract that states the signatory's fraud is not imputed to the company and, therefore, the signatory's fraud cannot serve as a basis for the insurer to rescind coverage. The Board has not adopted this suggestion. The Board is concerned that this level of specificity in a fidelity bond contract, along with the fact this would be a significant departure from current industry practice, would reduce the number

of fidelity bond insurance providers. A robust market for fidelity bond insurance ensures each FICU has options when determining appropriate insurance coverage. The Board believes, however, that if an insurer offers such a bond form it would likely address the Board's concerns regarding rescinded fidelity bond coverage and may alleviate the need for the board of directors to review each renewal and for a director to sign the renewal.

Most other comments focused on the potential burden of this provision. Some commenters expressed concern that this requirement could negatively affect a FICU's ability to recruit volunteer board members by increasing the perceived personal liability of the board member who is designated to sign the renewal. Other commenters thought insurance companies would either increase costs or modify contracts in response to the proposed rule. One commenter stated that the proposal is problematic due to the amount of time, bandwidth, and knowledge that is necessary to be a signatory, and believed it would require the board member to have a background in insurance. In contrast, one insurance company expressed support for this requirement, however, the company stated that the NCUA should impose additional requirements to ensure the signatory has done adequate due diligence before signing the bond renewal.

The Board is finalizing this provision as proposed. The Board has not made any changes to this proposed provision because the Board believes it is necessary to prevent losses to the NCUSIF due to rescinded coverage. The underlying purpose of these requirements is to address the issue of rescission of fidelity bond coverage when the signatory to the application to purchase or renew coverage is knowledgeable of

fraudulent activity. If the signatory to the application for purchase or renewal is knowledgeable of fraudulent activity, the bond issuer might void the policy and not make a payout when losses are discovered. The NCUA believes that a non-employee board member, who would not be involved in the day-to-day operations of a FICU, is less likely to be responsible for a fraudulent activity than an employee. The NCUA also believes that rotating signatories reduces the potential for the signatory to be knowledgeable of the fraudulent activity.

In recent years, the NCUSIF has sustained increased losses due to voided fidelity bond coverage. Before 2010, bond rescission was not a material concern for the NCUA. Since 2010, however, the NCUA has had at least three claims denied due to rescinded fidelity bond coverage and the NCUA is concerned that the frequency of rescinded coverage will continue to increase. Between 2010 and May 2019, the NCUSIF has already lost in excess of \$10 million from fidelity bonds that were voided due to the signatory being aware of fraudulent activities. Litigation related to denied claims is ongoing and may result in additional losses to the NCUA. The Board also notes that this requirement is also advantageous to individual FICUs, as this will help prevent them from losing coverage in cases not involving involuntary liquidation.

Finally, the Board believes the final rule presents only a minimal increase in regulatory burden as the FICU's board is already required to annually review its fidelity bond coverage, but meaningfully mitigates the risk to the NCUSIF associated with fidelity bond coverage rescission.

*§ 713.3 What bond coverage must a federally insured credit union have?*

The proposed rule amended current § 713.3 by renumbering and revising the section. Current § 713.3 became paragraph (a), current paragraphs (a) and (b) were renumbered as paragraphs (a)(1) and (a)(2), and two new subparagraphs were added as (a)(3) and (a)(4). Finally, a new paragraph (b) also was added.

*3(a)(2)*

Current paragraph (b) of § 713.3 states that, at a minimum, a FICU's fidelity bond coverage must include fidelity bonds that cover fraud and dishonesty. The proposed rule removed the redundant phrase "[i]nclude fidelity bonds that" in current paragraph (b). The Board did not receive any comment on this section and is finalizing this provision as proposed. The final rule reads "At a minimum, your bond coverage must: . . . Cover fraud and dishonesty by all employees, directors, officers, supervisory committee members, and credit committee members;"

*3(a)(3)*

The proposed rule added a new paragraph (a)(3) to § 713.3. Proposed paragraph (a)(3) required a FICU to have fidelity bond coverage that includes an option for the liquidating agent to purchase coverage that extends the discovery period, the period to

discover and file a claim, for at least two years after liquidation.<sup>15</sup> Most commenters objected to the proposed two-year discovery period following an involuntary liquidation. Most commenters cited the potential for increased premiums as the reason for their objection. In the proposed rule, the NCUA stated its belief that any additional cost of this provision would likely be covered by the liquidating agent as the liquidating agent would pay the fee for an extended discovery period.

Commenters, however, did not believe that the liquidating agent would bear all of the additional cost of the two-year discovery window because state insurance regulations cap the amount that an insurer can charge for an extended discovery period. Several commenters expressed concern that the NCUSIF savings would not justify the added cost to all FICUs due to the limited number of FICUs that are involuntarily liquidated. Several commenters requested that the NCUA undergo a cost-benefit analysis. One commenter stated that the NCUA did not present any evidence that the current policy of providing notice does not work, just that it lacks legal certainty. In contrast, two credit union commenters supported the extended discovery period. In addition, two commenters associated with the insurance industry suggested a 12-month discovery window. One stated that a 12-month window is in line with industry standards and encourages timely action by the liquidating agent. In response to the commenters, the Board has amended the proposed two-year discovery window.

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<sup>15</sup> The Board believes that an extended discovery period is important for protecting the NCUSIF as fidelity bonds mitigate the risk presented by fraudulent and other dishonest acts to the NCUSIF and have served as a significant source of recovery in liquidations caused by fraud.

In an effort to better balance the costs and benefits of the Board's intent, the Board has amended the final rule to require that fidelity bond contracts provide for a 12-month discovery window following an involuntary liquidation. The Board initially proposed a two-year discovery window as members have 18 months to file a claim on insured accounts after the appointment of a liquidating agent.<sup>16</sup> Upon consideration of the comments, the Board believes a 12-month discovery period provides adequate time to discovery and file a claim. Additionally, after conducting research, the Board believes that this proposed requirement will not result in any material additional cost or burden on FICUs.

*3(a)(4)*

The Board also proposed to add a new paragraph (a)(4) to § 713.3 to include a requirement that, for voluntary liquidations, a FICU's fidelity bond coverage remain in effect, or provide that the discovery period is extended, for at least four months after the final distribution of assets. There were only two comments on the proposed four-month discovery period following a voluntary liquidation. One commenter did not object to it. The other commenter did not support imposing the requirement on FISCUs and stated that state law governs voluntary liquidations for FISCUs. The Board believes that this requirement is important because it benefits a FICU's members as any recovery following a voluntary termination flows through to members. Additionally, the provision imposes only a minor burden for FISCUs. Therefore, the Board is finalizing this provision as proposed.

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<sup>16</sup> 12 U.S.C. 1787(o).

3(b)

Section 713.3 requires that a bond, at a minimum, must be purchased in “an individual policy.”<sup>17</sup> The NCUA added this section to Part 713 in a 1999 final rule in response to a commenter who pointed out that there had been instances of FICUs jointly purchasing fidelity bonds with each other.<sup>18</sup> The commenter was concerned that a loss caused by one or two of the joint policyholders could reduce the amount of available coverage for the other policyholders to below the required minimum amount. In addressing this comment, the Board provided in § 713.3 that a FICU must purchase its own individual policy.<sup>19</sup> The regulation did not, however, define “individual policy.”

Since inclusion of this provision in the NCUA’s regulations, OGC has issued two public legal opinions interpreting the meaning of “individual policy” and opining on the type of coverage that is prohibited under § 713.3(a).<sup>20</sup> A 2014 OGC legal opinion states that a FICU may not include one or more of its CUSOs or other parties as additional insureds under its fidelity bond.<sup>21</sup> In a 2004 legal opinion, OGC opined that a CUSO that provides management services for multiple credit unions could not purchase a single fidelity bond with each credit union named as an insured.<sup>22</sup> In both letters, OGC explained the purpose of the individual policy requirement is to avoid diluting the individual credit union’s coverage.

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<sup>17</sup> 12 CFR 713.3.

<sup>18</sup> 64 Fed. Reg. 28718, 28719 (May 27, 1999).

<sup>19</sup> *Id.* at 28719.

<sup>20</sup> OGC Legal Op. 04-0744 (Sep. 21, 2004); and OGC Legal Op. 14-1013 (Mar. 21, 2014).

<sup>21</sup> OGC Legal Op. 14-1013 (Mar. 21, 2014).

<sup>22</sup> OGC Legal Op. 04-0744 (Sep. 21, 2004).

As noted above, OGC issued a third legal opinion on the “individual policy” requirement in 2017 (2017 legal opinion). The 2017 legal opinion rescinded and replaced the previous two opinions and expanded the permissibility for certain joint coverage provisions under the “individual policy” requirement. OGC and the NCUA’s Office of Examination and Insurance determined this broader interpretation was both within the NCUA’s legal authority under the FCU Act and a safe and sound practice for FICUs. For clarity and ease of reference, the Board sought to incorporate the 2017 legal opinion into proposed Part 713.

No commenters opposed this policy and several commenters supported it. The Board is finalizing this provision as proposed. Under the final rule, a FICU may have a fidelity bond that also covers its CUSO(s) if the FICU owns greater than 50 percent of a CUSO it wishes to cover, or a covered CUSO is organized by the FICU for the purpose of handling certain of its business transactions and composed exclusively of its employees. The 50 percent threshold reflects the standard for accounting consolidation under generally accepted accounting principles, or GAAP. A FICU directly benefits from any fidelity bond insurance proceeds collected by a consolidated CUSO.<sup>23</sup> This final rule, however, does not eliminate the prohibition against joint coverage of entities not majority owned by the FICU, such as other credit unions or non-majority-owned

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<sup>23</sup> As discussed in the 2017 legal opinion, the NCUA has previously approved certain nominee provisions that included limited joint coverage. For example, a nominee provision may state that a loss sustained by any “nominee” organized by the insured for the purpose of handling certain of its business transactions and composed exclusively of its employees shall be deemed to be loss sustained by the insured.

CUSOs. The Board believes this amendment will provide greater flexibility to FICUs without affecting safety and soundness.<sup>24</sup>

*§ 713.4 What bond forms may a federally insured credit union use?*

The current rule provides that the NCUA will maintain a current list of bond forms approved by the Board for use by FICUs. The rule also states that a FICU must obtain the approval of the Board before it can use any other basic bond form or any rider or endorsement that limits coverage of an approved bond form. The Board proposed to amend § 713.4 to make several changes to reflect the practices of the NCUA, clarify the list of documents that must have Board approval, and address the expiration and continuing review of approved bond forms. The Board received several comments that addressed the expiration and continuing review of approved bond forms. Those comments are discussed below. Other than the expiration of bond form approval, the Board did not receive any comments that generally discussed its approval of bond forms. Therefore, this section has generally been finalized as proposed. Any questions regarding the NCUA's approval of fidelity bond forms can be directed to the NCUA's OGC, (703) 518-6540.

4(a)

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<sup>24</sup> The final rule is not making a comparable amendment to Part 704. Corporate credit unions are not required to purchase fidelity bonds subject to an individual policy requirement. Therefore, the amendment to clarify the individual policy requirement is only applicable to natural person credit unions.

Current § 713.4(a) states that a current listing of basic bond forms that may be used without prior Board approval is on the NCUA's website. The proposed rule clarified this requirement by dividing paragraph (a) into two new paragraphs. The Board did not receive any comment on this section and is finalizing this provision as proposed. New paragraph (a) explicitly states that "the NCUA Board must approve all bond forms before federally insured credit unions may use them."

*4(b)*

Proposed paragraph (b) stated that approved bond forms are listed on the NCUA's website and may be used by a FICU without further NCUA approval. If a FICU is unable to access the NCUA's website, it can get a current listing of approved bond forms by contacting the NCUA at (703) 518-6330. The proposed rule rewrote this provision for clarity, but did not make any substantive changes. The Board did not receive any comment on this section and is finalizing it as proposed.

*4(c)*

Proposed paragraph (c) set forth which fidelity bonds and fidelity bond documents require Board approval. The Board is finalizing this paragraph as proposed.

*4(c)(1)*

The final rule clarifies that any bond form that has been amended or changed since the Board approved it requires new approval from the Board. The Board notes that

this policy is the current practice whereby bond issuers submit amended bond forms to the Board for approval under current § 713.4(b)(1).

*4(c)(2)*

The final rule states explicitly that renewal forms (and any other document) that limit the coverage of approved bond forms must also receive Board approval. The Board is clarifying the list of documents subject to approval because the Board is aware of instances where the renewal or continuation of coverage forms included language affecting the bond coverage, including language that limited the bond coverage. As such, it is the Board's belief that the renewal form is an extension of the bond form and thus this is not an additional burden but further clarification of what constitutes the bond form.

*4(d)*

The proposed rule also added a new paragraph (d) to sunset its approval on all bond forms ten years after the form is approved. The impetus for this provision is the discovery that Board approved-bond forms were being interpreted in a way that was contrary to the NCUA's understanding of how the bond forms would be used. In addition, a review of previously approved bond forms, as part of issuing the 2017 legal opinion, revealed several instances of outdated provisions, additions that had not been approved by the Board, and some forms that contained provisions that were contrary to the FCU Act and Part 713 of the NCUA's regulations. To avoid instances of this in the future, the Board proposed to sunset its approval of a bond form after a period of ten years. Commenters had mixed opinions on this provision. While several commenters

supported the ten-year sunset, many other commenters expressed concerns about the ten-year sunset date. Specifically, two commenters associated with the insurance industry expressed concerns because form approval is already a complicated process as it involves state insurance regulators. The Board understands the complexity involved in the approval process, but is maintaining the ten-year sunset. The Board believes the sunset is necessary to ensure bond forms are up-to-date and continue to provide adequate fidelity bond coverage for FICUs.

With respect to bond forms that the Board has approved before 2019, the Board proposed to allow its approval on these forms to continue until January 1, 2029. Several commenters expressed concerns about the NCUA's ability to reapprove bond forms, and particularly, reapprove all existing bond forms in 2029. Commenters believed that re-approval would be a resource-intensive process and suggested that the NCUA include qualifying language in case there is a delay and the NCUA has not reapproved all bond forms by their expiration date. The Board agrees that qualifying language is beneficial. Therefore, the final rule provides that approval for all existing bond forms sunsets after ten years unless otherwise determined by the NCUA Board.<sup>25</sup> The Board believes the addition of qualifying language provides reasonable flexibility while preserving its intent to sunset bond form approval after ten years.

Under the proposed rule, the ten-year approval period began on the date the Board approved a bond form. The proposed rule stated, however, that the ten-year period would

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<sup>25</sup> The Board has added this flexibility both for the general ten-year sunset provision and for the 2029 sunset date for all currently approved bond forms.

not toll or start over if a bond carrier submits a revision to an approved bond form. One commenter believed that this is unnecessary and approval should always sunset ten years after a bond form is reviewed and approved. The Board has reconsidered and agrees with the commenter. Under the final rule, the Board's approval always sunsets ten years after a bond is reviewed and approved. The Board proposed to maintain the original sunset date because of concerns that a subsequent review may be targeted and not review the bond form in its entirety. To address this concern, under the final rule, a bond form will always be reviewed in its entirety.

The proposed rule also noted that should the Board determine, upon re-review, that a bond form does not comply with the NCUA's regulations, the Board would not require FICUs with coverage under that bond to seek new coverage. One commenter objected to this provision and believed that if the coverage is not adequate, new coverage should be required immediately. The Board is supportive of adequate fidelity bond coverage, but is concerned about the burden to a FICU if the contract is determined to be inadequate during the contract term. Therefore, under the final rule a FICU must only seek new coverage under an approved bond form after its current coverage expires per the terms of the contract between the FICU and the bond issuer.

The proposed rule also clarified that the Board may review a bond form at any time. The Board received no comment on this provision and is finalizing it as proposed.

*§ 713.5 - § 713.7*

The proposed rule used the term federally insured credit union instead of federal credit union in each of §§ 713.5, 713.6, and 713.7 for consistency and clarity. The Board did not receive any comment on these sections and is finalizing them as proposed.

#### *Part 704*

In general, Part 704 applies to all federally insured corporate credit unions. Section 704.18 provides the fidelity bond requirements for such credit unions. Changes to the specific subparagraphs of § 704.18 are discussed below.

#### *§ 704.18 Fidelity bond coverage.*

#### *18(b)*

The proposed rule amended current § 704.18(b) by dividing paragraph (b) into two subparts. Current paragraph (b) remained unchanged and was designated paragraph (b)(1). The proposed rule added a new paragraph as (b)(2). Proposed paragraph (b)(2) required that a corporate credit union's board of directors and supervisory committee review all applications for purchase or renewal of its fidelity bond coverage. After review, the corporate credit union's board was required to pass a resolution approving the purchase or renewal of fidelity bond coverage and delegate one member of the board, who is not an employee of the corporate credit union, to sign the purchase or renewal agreement and all attachments. No board member was permitted to be a signatory on consecutive purchase or renewal agreements for the same fidelity bond coverage policy. This proposed amendment was identical to proposed changes to Part 713 for natural

person credit unions. The Board received significant comment on this proposed requirement. As compared to the proposed rule, the final rule does not require that the corporate credit union's supervisory committee review all applications for purchase or renewal. The Board is finalizing the remaining requirements of this paragraph as proposed. For additional background and a detailed discussion of comments received, see the previous discussion for changes to § 713.2(b).

*18(c)*

The proposed rule made significant revisions to current § 704.18(c). Section 704.18(c) was split into five new subparagraphs, each of which is described in more detail below.

*18(c)(1)*

The proposed rule stated that a corporate credit union's fidelity bond coverage must be purchased from a company holding a certificate of authority from the Secretary of the Treasury. This was not a substantive change from the current requirements and the proposed language was intended to reflect the comparable language in Part 713. The Board did not receive any comment on this provision and is finalizing it as proposed.

*18(c)(2)*

Proposed § 704.18(c)(2) stated that fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit

committee members. This was not a substantive change from the current requirements and the Board is finalizing this provision as proposed.

*18(c)(3)*

The proposed rule substantively amended the requirements for a corporate credit union's approved bond forms. The proposed requirements reflected the changes proposed for natural person credit unions in Part 713. The proposed rule required the Board to approve all bond forms before a corporate credit union may use them. In addition, a corporate credit union could not use any bond form that had been amended since receiving Board approval, or any rider, endorsement, renewal, or other document that limited coverage of approved bond forms, without first receiving approval from the Board. As required under proposed Part 713, approval of all bond forms expired 10 years after the date the Board approved or reapproved use of the bond form. Any currently approved bond forms would expire on January 1, 2029. The Board is finalizing this provision as proposed with one exception. As compared to the proposed rule, the final rule adds qualifying language to provide the Board flexibility to extend its approval of bond forms. For additional background, and a detailed discussion of comments, see the previous discussion for changes to § 713.4.

*18(c)(4)*

The proposed rule added a new § 704.18(c)(4) to ensure that there is an adequate discovery period, the period to discover and file a claim, following a corporate credit union's liquidation. The proposed requirements reflected the changes proposed for

natural person credit unions in Part 713. The proposed rule required fidelity bonds to include an option for the liquidating agent to purchase coverage in the event of an involuntary liquidation that extended the discovery period for a covered loss for at least two years after liquidation. The Board is finalizing this provision as proposed with one substantive modification. The final rule requires only a one-year discovery period following an involuntary liquidation. In the case of a voluntary liquidation, under the proposed rule, fidelity bonds were required to remain in effect, or provide that the discovery period is extended, for at least four months after the final distribution of assets. The Board is finalizing this provision as proposed. For additional background and a detailed discussion of comments, see the previous discussion for changes to §§ 713.3(a)(3) and (4).

*18(c)(5)*

The current rule requires that corporate credit union bond forms include a provision requiring written notification by surety to the NCUA when a credit union's bond is terminated or when the coverage of an employee, director, officer, supervisory or credit committee member has been terminated. The NCUA also must be notified in writing by surety if a deductible is increased above permissible limits. The proposed rule did not include any amendments to these requirements. One commenter, however, objected to the existing requirements and stated that the corporate credit union, and not the insurer, should be responsible for providing the required notice. This comment is outside the scope of the proposed rule, but the Board notes that it continues to believe that the insurance company should notify the NCUA if any of the listed events occur.

## **IV. Regulatory Procedures**

### *a. Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et seq.*) requires that the Office of Management and Budget (OMB) approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a current, valid OMB control number.

The burden outline in the preamble of the notice of proposed rulemaking did not include those associated with corporate credit unions. As with part 713, part 704 is being amended to require NCUA approval on all bond forms expired after a period of 10 years from the date of the NCUA approval or reapproved of its use. This information collection requirement is estimated to impact two corporate credit unions, for a total of two additional burden hours. This program change is reflected in the 19 total burden hours requested.

In accordance with the PRA, the information collection requirements included in this final rule have been submitted to OMB for approval under control number 3133–0170.

### *b. Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a final rulemaking, an agency prepare and make available for public comment a final

regulatory flexibility analysis that describes the impact of a final rule on small entities. A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include credit unions with assets less than \$100 million) and publishes its certification and a short, explanatory statement in the Federal Register together with the rule.

The Board does not believe that the final rule has a significant economic impact on a substantial number of small entities. Any increased costs for the bond insurer to resubmit their forms every ten years is spread out among all FICUs and the cost to each FICU is negligible. In addition, after conducting research the Board believes that the requirement for bond forms to include a 12-month discovery period following liquidation will not result in any material additional cost or burden on FICUs. Finally, the requirement that boards must approve purchases and renewals would impose no direct cost on FICUs. Accordingly, the NCUA certifies that the final rule does not have a significant economic impact on a substantial number of small FICUs.

*c. Executive Order 13132*

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. § 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. This final rule does not have a direct effect on the states, on the relationship between the national government

and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has therefore determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

*d. Assessment of Federal Regulations and Policies on Families*

The NCUA has determined that this final rule does not affect family well-being within the meaning of § 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

*e. Small Business Regulatory Enforcement Fairness Act*

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) (SBREFA) generally provides for congressional review of agency rules.<sup>26</sup> A reporting requirement is triggered in instances where the NCUA issues a final rule as defined by Section 551 of the APA.<sup>27</sup> An agency rule, in addition to being subject to congressional oversight, may also be subject to a delayed effective date if the rule is a “major rule.”<sup>28</sup> The NCUA does not believe this rule is a “major rule” within the meaning of the relevant sections of SBREFA. As required by SBREFA, the NCUA submitted this final rule to the Office of Management and Budget (OMB) for it to determine if the final rule is a “major rule” for purposes of SBREFA. OMB determined

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<sup>26</sup> 5 U.S.C. 801-804.

<sup>27</sup> 5 U.S.C. 551.

<sup>28</sup> 5 U.S.C. 804(2).

the final rule was not a major rule. The NCUA also will file appropriate reports with Congress and the Government Accountability Office so this rule may be reviewed.

**List of Subjects in**

**12 CFR Parts 704 and 713**

Bonds, Credit unions, Insurance

By the National Credit Union Administration Board on July 18, 2019.

/S/

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Gerard Poliquin  
Secretary of the Board

For the reasons discussed above, the NCUA is amending 12 CFR parts 704 and 713 as follows:

**PART 704 – CORPORATE CREDIT UNIONS**

1. The authority citation for part 704 continues to read as follows:

**Authority:** 12 U.S.C. 1762, 1766(a), 1772a, 1781, 1789, and 1795e.

2. Section 704.18 is amended by revising paragraphs (b) and (c) to read as follows:

**§ 704.18 Fidelity bond coverage.**

\* \* \* \* \*

(b) *Review of bond coverage.*

(1) The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

(2) The board of directors of each corporate credit union must review all applications for purchase or renewal of its fidelity bond coverage. After review, the credit union's board must pass a resolution approving the purchase or renewal of fidelity bond coverage and delegate one member of the board, who is not an employee of the credit union, to sign the purchase or renewal agreement and all attachments; provided, however, that no board members may be a signatory on consecutive purchase or renewal agreements for the same fidelity bond coverage policy.

(c) *Minimum coverage; approved forms.*

(1) The fidelity bond coverage must be purchased from a company holding a certificate of authority from the Secretary of the Treasury.

(2) Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members.

(3) The NCUA Board must approve all bond forms before a corporate credit union may use them. Corporate credit unions may not use any bond form that has been amended since the time the NCUA Board approved the form or any rider, endorsement, renewal, or other document that limits coverage of approved bond forms without receiving approval from the NCUA Board. Approval on all bond forms expires 10 years after the date the NCUA Board approved or reapproved use of the bond form unless otherwise determined by the NCUA Board; provided, however, that any bond forms approved before 2019 will expire on January 1, 2029, unless otherwise determined by the NCUA Board. The NCUA reserves the right to review a bond form at any point after its approval.

(4) Fidelity bonds must include an option for the liquidating agent to purchase coverage in the event of an involuntary liquidation that extends the discovery period for a covered loss for at least one year after liquidation. In the case of a voluntary liquidation, fidelity bonds must remain in effect, or provide that the discovery period is extended, for at least four months after the final distribution of assets.

(5) Notwithstanding the foregoing, all bonds must include a provision, in a form approved by the NCUA Board, requiring written notification by surety to NCUA:

(i) When the fidelity bond of a credit union is terminated in its entirety;

(ii) When fidelity bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or

(iii) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.

\* \* \* \* \*

### **PART 713 – FIDELITY BOND AND INSURANCE COVERAGE FOR FEDERAL CREDIT UNIONS**

3. The authority citation for Part 713 continues to read as follows:

**Authority:** 12 U.S.C. 1761a, 1761b, 1766(a), 1766(h), 1789(a)(11).

4. Revise the title and table of contents for this Part to read as follows:

**PART 713 – FIDELITY BOND AND INSURANCE COVERAGE FOR  
FEDERALLY INSURED CREDIT UNIONS**

§ 713.1 What is the scope of this section?

§ 713.2 What are the responsibilities of a federally insured credit union’s board of directors under this section?

§ 713.3 What bond coverage must a federally insured credit union have?

§ 713.4 What bond forms may a federally insured credit union use?

§ 713.5 What is the required minimum dollar amount of coverage?

§ 713.6 What is the permissible deductible?

§ 713.7 May the NCUA Board require a federally insured credit union to secure additional insurance coverage?

5. Revise § 713.1 to read as follows:

**§ 713.1 What is the scope of this section?**

This section provides the requirements for fidelity bonds for federally insured credit union employees and officials and for other insurance coverage for losses such as theft, holdup, vandalism, etc., caused by persons outside the credit union. Federally insured, state-chartered credit unions are required by § 741.201 of this chapter to comply with the fidelity bond coverage requirements of this part. Corporate credit unions must comply with § 704.18 of this chapter in lieu of this part.

6. Revise § 713.2 to read as follows:

**§ 713.2 What are the responsibilities of a federally insured credit union's board of directors under this section?**

(a) The board of directors of each federally insured credit union must at least annually review its fidelity and other insurance coverage to ensure that it is adequate in relation to the potential risks facing the federally insured credit union and the minimum requirements set by the NCUA Board; and

(b) The board of directors of each federally insured credit union must review all applications for purchase or renewal of its fidelity bond coverage. After review, the federally insured credit union's board must pass a resolution approving the purchase or renewal of fidelity bond coverage and delegate one member of the board, who is not an employee of the federally insured credit union, to sign the purchase or renewal agreement and all attachments; provided, however, that no board members may be a signatory on consecutive purchase or renewal agreements for the same fidelity bond coverage policy.

7. Revise § 713.3 to read as follows:

**§ 713.3 What bond coverage must a federally insured credit union have?**

(a) At a minimum, your bond coverage must:

(1) Be purchased in an individual policy from a company holding a certificate of authority from the Secretary of the Treasury;

(2) Cover fraud and dishonesty by all employees, directors, officers, supervisory committee members, and credit committee members;

(3) Include an option for the liquidating agent to purchase coverage in the event of an involuntary liquidation that extends the discovery period for a covered loss for at least one year after liquidation; and

(4) In the case of a voluntary liquidation, remain in effect, or provide that the discovery period is extended, for at least four months after the final distribution of assets, as required in § 710.2(c) of this chapter.

(b) The requirement in subsection (a) of this section does not prohibit a federally insured credit union from having a fidelity bond that also covers its credit union service organization (CUSO(s)), provided the federally insured credit union owns more than 50 percent of the CUSO(s) or the CUSO(s) is organized by the federally insured credit union for the purpose of handling certain of its business transactions and composed exclusively of the federally insured credit union's employees.

8. Revise § 713.4 to read as follows:

**§ 713.4 What bond forms may a federally insured credit union use?**

(a) The NCUA Board must approve all bond forms before federally insured credit unions may use them.

(b) Bond forms the NCUA Board has approved for use by federally insured credit union are listed on the NCUA's website, <http://www.ncua.gov>, and may be used by federally insured credit unions without further NCUA approval. If you are unable to access the NCUA's website, you can obtain a current listing of approved bond forms by contacting the NCUA at (703) 518-6330.

(c) Federally insured credit unions may not use any of the following without first receiving approval from the NCUA Board:

(1) Any bond form that has been amended or changed since the time the NCUA Board approved the form; and

(2) Any rider, endorsement, renewal, or other document that limits coverage of approved bond forms.

(d) Approval on all bond forms expires after a period of 10 years from the date the NCUA Board approved or reapproved use of the bond form unless otherwise determined by the NCUA Board. Provided, however, that:

(1) Any bond forms approved before 2019 will expire on January 1, 2029, unless otherwise determined by the NCUA Board; and

(2) The NCUA reserves the right to review a bond form at any point after its approval.

9. In §§ 713.5(a) and (b) remove the word “federal” before the words “credit union’s” and add in its place the words “federally insured” each place they appear.

10. In § 713.5(c) add the words “federally insured” before the words “credit union,” “credit unions,” or “credit union’s” each place they appear.

11. In § 713.5(e) replace the word “your” with the words “a federally insured credit union’s”.

12. In § 713.6 remove the word “federal” before the words “credit union’s” or “credit unions” and add the words “federally insured” before the words “credit union’s,” “credit unions,” and “credit union” each place they appear.

13. Revise § 713.7 to read as follows:

**§ 713.7 May the NCUA Board require a federally insured credit union to secure additional insurance coverage?**

The NCUA Board may require additional coverage when the NCUA Board determines that a federally insured credit union's current coverage is inadequate. The federally insured credit union must purchase this additional coverage within 30 days.