



FRANÇOIS G. HENRIQUEZ, II  
PARTNER  
CREDIT UNION PRACTICE GROUP  
Shutts & Bowen LLP  
200 South Biscayne Boulevard  
Suite 4100  
Miami, Florida 33131  
DIRECT (305) 415-9076  
FAX (305) 347-7821  
EMAIL fhenriquez@shutts.com

November 23, 2015

Via email to: [regcomments@ncua.gov](mailto:regcomments@ncua.gov)

Mr. Gerard Poliquin  
Secretary to the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Proposed Rule – “Bank Notes”

Dear Mr. Poliquin:

Shutts & Bowen LLP is pleased to have the opportunity to comment on the National Credit Union Administration (“**NCUA**”) proposal to revise NCUA’s rules and regulations (the “**NCUA Rules**”) in a manner that would provide additional flexibility for federally chartered natural person credit unions as to which bank notes they can purchase (the “**Proposed Rule**”).

According to NCUA’s Release of the Proposed Rule (the “**Release**”),<sup>1</sup> “[t]he NCUA Board (Board) proposes to amend the maturity requirement for bank notes to be permissible investments for federal credit unions (FCUs) by removing the word “original” from the current requirement that bank notes have ‘original weighted average maturities of less than 5 years.’”<sup>2</sup> The Proposed Rule would amend Section 703.14(f)(5) of the NCUA Rules (the “**Current Rule**”) to align the characterization of “bank notes” as “deposits” under NCUA Rules with the definitional sections of Regulation D of the Board of Governors of the Federal Reserve. As stated in the Release,

By NCUA regulation, bank notes with original weighted average maturities of less than 5 years are permissible investments for FCUs. The authority for FCUs to invest in these bank notes is derived from the provision of the Federal Credit Union Act (the Act) that permits FCUs to make deposits in, among other things, national and state banks. The Act does not provide authority for FCUs to purchase bank notes that are not deposits. The Act, however, does not define “deposit.” NCUA’s long-standing policy has been to use the definition of deposit in Regulation D. Regulation D provides, in relevant part, that a liability of a depository institution can be a “deposit” if, among other things: (1) It is insured; (2) it is not subordinated to the claims of depositors; and (3) it has a weighted

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<sup>1</sup> See, 80 F.R. 63932 (October 22, 2015), National Credit Union Administration: “Investment and Deposit Activities— Bank Notes.”

<sup>2</sup> NCUA Rules Section 703.14(f)(5) currently provides that, “A Federal credit union may invest in... Bank notes with *original* weighted average maturities of less than 5 years.” (Emphasis added.)

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average maturity of less than five years. The Board notes that the third prong of the above test does not include the word "original."<sup>3</sup>

From our perspective, the Proposed Rule effectively expands the range of investment opportunities available to federal credit unions without increasing the nature or level of risk NCUA apparently intended to permit under the Current Rule.

It is our understanding that most bank notes are issued with an original stated maturity of 3, 5, or 7 years, and that a growing percentage of bank notes are being issued with original stated maturities of 10 years. As a result, the Current Rule has the (presumably) unintended consequence of limiting federal credit unions' investments in bank notes to those with original maturities of 3 years. Under the Proposed Rule, federal credit unions would gain the ability to invest in bank notes with *remaining* maturities of less than 5 years, but *original* maturities of 5 years and longer, thereby taking advantage of a much broader range of high-quality, seasoned investments. We note that the Current Rule potentially fails to take into consideration a federal credit union's actual credit risk exposure with respect to a given investment. For example, a bank note with 6 months remaining to maturity (regardless of its original stated maturity) likely presents materially less credit risk exposure to a federal credit union than a newly-issued bank note with a 5- or 7-year stated maturity.

Despite the fact that it would increase the number of investments available to federal credit unions, the Proposed Rule would not permit federal credit unions to assume the investment risks that would correspond with bank notes having maturities of 5 five years and longer. As a result, the Proposed Rule would not require federal credit unions or their examiners to modify existing standards for credit due diligence and risk management practices.

Considering the foregoing, we recommend that the NCUA Board adopt the Proposed Rule as originally proposed. Once again, we appreciate the opportunity to comment on the Proposed Rule and hope our comments are useful to NCUA.

Very truly yours,

Shutts & Bowen LLP



François G. Henriquez, II

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<sup>3</sup> See, 80 F.R. 63932 (citations omitted).