



National Credit Union Administration
Office of General Counsel

August 30, 2018

Sara W. Trexler, Chief Legal Officer/General Counsel
State Employees' Credit Union
119 N. Salisbury Street, 11th Floor
P.O. Box 27491
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RE: Other Similar Escrow Account Share Insurance Coverage – North Carolina 529 Account

Dear Ms. Trexler:

You have asked if the below described “529 Account,” which State Employees’ Credit Union (SECU) maintains, would qualify as an “other similar escrow account” under §745.14 of the National Credit Union Administration’s (NCUA) regulations. If qualifying, the account would be eligible for National Credit Union Share Insurance Fund coverage on a pass-through basis (pass-through share insurance coverage) due to the credit union membership of the State Education Assistance Authority (Authority), a political subdivision of the State of North Carolina, and its agent, the College Foundation, Inc. (Foundation), a nonprofit, special purpose corporation organized under the laws of the State of North Carolina. While not all 529 accounts across the country would necessarily qualify for pass-through share insurance coverage, we believe the subject account does.¹

Our determination that the subject 529 Account, if offered in North Carolina by SECU, qualifies to receive pass-through share insurance coverage as an “other similar escrow account” is based largely on SECU’s factual representations regarding: (1) the nature and structure of the subject 529 Account; (2) the structure of the North Carolina State government and its political subdivisions and agents; and (3) applicable North Carolina State law. Accordingly, the availability of pass-through share insurance coverage for the subject 529 Account depends on the accuracy of SECU’s representations.

The below share insurance analysis does not apply to any similarly named tax advantaged accounts or any other accounts where the factual and legal circumstances differ, even slightly, from those presented in the subject 529 Account context. Rather, the conclusions reached in this opinion are expressly limited to the specific facts and circumstances surrounding the subject 529 Account. This and any future determinations under §745.14 of the NCUA’s regulations are made strictly on a case-by-case basis. However, as discussed in the NCUA’s Guidance on Enhanced Share Insurance (Guidance),² we are issuing this legal opinion to help federally insured credit unions: (1) better understand the concept of an “other similar escrow account”; and (2) identify accounts eligible for pass-through share insurance coverage.

¹ As discussed below, North Carolina State law plays a critical role in this determination.

² NATIONAL CREDIT UNION ADMINISTRATION, NCUA OFFICE OF GENERAL COUNSEL’S GUIDANCE ON ENHANCED SHARE INSURANCE (2016), available at <https://www.ncua.gov/regulation-supervision/Documents/Regulatory%20Alerts/RA2016-02-enclosure.pdf>.

Factual Background

You have made the following representations regarding the subject 529 Account, also referred to as the Deposit Account, and the factual circumstances surrounding the creation and maintenance of the account. The Deposit Account is maintained as part of SECU's offering of a deposit account investment option to Participants in North Carolina's college savings program, commonly known as the NC 529 Plan. A description of the NC 529 Plan, SECU's deposit account investment option and the Deposit Account follow.

North Carolina College Savings and Investment Program

In order to enable qualified parents and other interested parties to save funds to meet the costs of postsecondary³ education expenses of eligible students, the Authority, a North Carolina political subdivision, has established the North Carolina College Savings and Investment Program (Program). N.C. Gen. Stat. § 116-203(a). The Program is designed to meet the requirements of a "qualified tuition program" under Section 529 of the Internal Revenue Code of 1986, as amended (Code). As such, the Program provides a tax-advantaged vehicle for education savings.

As part of the Program, the General Assembly of North Carolina has established the Parental Savings Trust Fund (Fund) to serve as the "qualified trust" referenced in section 529(b)(1)(B) of the Code. N.C. Gen. Stat. § 116-209.25. The Authority administers and serves as the trustee of the Fund. *Id.* The Authority accepts, holds, invests, and disburses contributions, and interest earned on such contributions, from qualified parents and other interested parties in its capacity as trustee of the Fund. *Id.* Pursuant to statutory mandate, the assets of the Fund are at all times [to] be preserved, invested, and expended solely for the purposes of the Fund and held in trust for the Participants and their designated beneficiaries (Beneficiary). *Id.*

Adults, emancipated minors and certain entities (Participants), who are eligible for the Program, establish accounts representing interests in the Fund (Accounts). Participants include members and non-members of SECU.

Participants and other contributors may make cash contributions to those Accounts (Contributions). The Participants designate one or more investment options (Investment Options) for the funds represented by the Account.

The Participant retains ownership of and control over the Account, all Contributions made to the Account, and all earnings credited to the Account until amounts are withdrawn. A Beneficiary who is not the Participant has no control over any of the Account assets.

Only the Participant may direct the withdrawal of funds in cash from the Participant's Account (Withdrawal). The Participant may make a Withdrawal at any time. If the Withdrawal is used for the payment of certain qualified higher education expenses of the Beneficiary (as set forth in

³ Effective July 1, 2018, the North Carolina General Assembly amended N.C. Gen. Stat. § 116-209.25(b) to capture the favorable tax treatment now also accorded for withdrawals for certain elementary and secondary school tuition costs. See N.C. Sess. Laws 2018-5, § 38.1 (i).

the Code), the Withdrawal is deemed "qualified," and the Withdrawal is afforded favorable tax treatment. All other Withdrawals are deemed "non-qualified" and, unless an exemption applies, the earnings portion of a non-qualified Withdrawal is subject to federal income tax, an additional federal income tax of 10% and, potentially, state income tax.

College Foundation, Inc.

The Foundation is a nonprofit, special purpose corporation organized under the laws of the State of North Carolina. The Authority has designated the Foundation, as agent of the Authority, to serve as central administrator for the Program. In that capacity, and at the direction of the Authority pursuant to the Third Amended and Restated Administrative Agreement, dated as of February 27, 2008 (Administrative Agreement), the Foundation performs certain ministerial, marketing, recordkeeping, tax reporting, regulatory compliance, operational services and other functions in connection with the operation of the Program. The Administrative Agreement also authorizes the Foundation to contract for certain management services for the Investment Options of the Fund on behalf of the Authority.

At all times, in the conduct of its functions for the Program, the Foundation operates in compliance with the Code, North Carolina law governing the Program, the Program Rules and the Authority's Investment Policy. Under the terms of the Authority's Investment Policy for the Fund, both the Foundation and the Authority act in a fiduciary capacity with regard to the administration of the Program.

The delegation of administrative and operational functions under the Administrative Agreement establishes the Foundation's obligation to honor the Authority's statutory mandate to preserve, invest and expend Fund assets at all times solely for the purposes of the Fund and hold the Fund in trust for the Participants and their Beneficiaries. In addition, the Administrative Agreement obligates the Foundation to carry out the delegation in compliance with all applicable law and rules.

Federally-Insured Deposit Account Investment Option

The Authority has authorized the Foundation to contract with SECU to offer Participants the Federally-Insured Deposit Account Investment Option (FIDA Investment Option).

The FIDA Investment Option is designed to offer Participants protection of principal along with a modest rate of return. SECU is contractually obligated to pay all Contributions allocated to the FIDA Investment Option, together with the interest earnings thereon. The FIDA Investment Option earns interest at a rate set by the SECU Board of Directors. Interest is compounded daily and credited on a monthly basis. SECU does not charge Participants any fees associated with the assets on deposit in the FIDA Investment Option.

The Deposit Account

The Authority, in its capacity as trustee of the Fund, and acting through its agent, the Foundation, deposits Fund assets allocated by Participants to the FIDA Investment Option to a single deposit account at SECU (Deposit Account). The Foundation, in its capacity as agent for the Authority,

itself in its capacity as trustee of the Fund, owns and administers the Deposit Account. Inflows and outflows from the Deposit Account occur through a daily settlement process with the Foundation, acting on behalf of the Authority.

If a Participant allocates a Contribution to the FIDA Investment Option, the Foundation, acting pursuant to its delegated authority as agent of the Authority, itself acting as trustee of the Fund, will cause the deposit of corresponding Fund assets into the Deposit Account. Likewise, if a Participant reallocates or withdraws a Contribution from the FIDA Investment Option, the Foundation, acting pursuant to its delegated authority as agent of the Authority, itself acting as trustee of the Fund, will cause the withdrawal of corresponding Fund assets from the Deposit Account.

Membership

The Foundation and the Authority are members of SECU.

Recordkeeping

The account records associated with the Deposit Account shall disclose the existence of the agent and trustee relationship between, respectively, the Foundation and the Authority and the Authority and Participants. The details of the relationships -including the identity and interests of the various Participants- shall be ascertainable from the records of the Foundation maintained in good faith and in the regular course of business.

Analysis

Section 745.14 of the NCUA's share insurance regulations provides for pass-through share insurance coverage for "interest on lawyers trust accounts" (IOLTAs) and "other similar escrow accounts."⁴ Pass-through share insurance means, with respect to IOLTAs and other similar escrow accounts, that the insurance coverage is based on the interest of each person on whose behalf funds are held in the account by the attorney administering the IOLTA or the escrow agent administering the other similar escrow account.⁵

More specifically, to the extent membership and other regulatory requirements are satisfied, the shares in any IOLTA or other similar escrow account held in a federally insured credit union are insured on a "pass-through" basis, in an amount of up to the standard maximum share insurance amount of \$250,000⁶ for each client or principal on whose behalf funds are held in such accounts by either the attorney administering the IOLTA or the escrow agent administering a similar escrow account. Further, funds attributable to each client or principal will be insured on a pass-through basis in whatever right and capacity the client or principal owns the funds.

⁴ An IOLTA is an account opened as part of a system in which lawyers place certain client funds in interest-bearing or dividend-bearing accounts, with the interest or dividends then used to fund programs such as legal service organizations that provide services to clients in need. 12 C.F.R. §745.14.

⁵ The terms "interest on lawyers trust account", "IOLTA", and "pass-through share insurance" are given the same meaning in 12 C.F.R. Part 745 of the NCUA's regulations as in 12 U.S.C. 1787(k)(5) of the Federal Credit Union Act.

⁶ 12 C.F.R. §745.1(e).

IOLTAs and other similar escrow accounts are considered member accounts⁷ and eligible for pass-through share insurance if the attorney administering the IOLTA or the agent administering the other similar escrow account is a member of the federally insured credit union in which the funds are held. In this circumstance, the membership status of the client or the principal is irrelevant.⁸

As noted in more detail above, SECU describes the subject 529 Account as allowing the Foundation, as the agent of the Authority, the trustee of the Parental Savings Trust Fund, to deposit a plan participant's contributions in the fund and to hold the funds in trust for the participant in compliance with federal law and the laws of the State of North Carolina. In determining if the subject 529 Account is eligible for pass-through share insurance coverage, we must determine if the account, which clearly is not an IOLTA, satisfies all aspects of the definition of "other similar escrow account."

Section 745.14(c)(1)(ii) of the NCUA's regulations defines an "other similar escrow account" as an account where: (1) a licensed professional or other individual; (2) serving in a fiduciary capacity; (3) holds funds for the benefit of a client or principal as part of a transaction or business relationship. The definition also states that "[e]xamples of such accounts include, but are not limited to, real estate escrow accounts and prepaid funeral accounts."⁹

(1) A licensed professional or other individual

With respect to the first element of the definition of "other similar escrow account" that requires the account holder (agent) to be a member of the credit union and a "licensed professional or other individual," the preamble to the IOLTA rule¹⁰ and subsequent guidance provide that the account holder is not strictly limited to being an individual to satisfy the definition. More specifically:

The enhanced pass-through coverage applies to IOLTAs and other similar escrow accounts opened and administered by individual attorneys and escrow agents as well as entities, such as law firms, real estate agencies, and funeral homes. However, these accounts must still satisfy the fiduciary relationship requirement, which may or may not require an individual lawyer or escrow agent to also be named on the account. That is subject to state law. Also, the [Credit Union Share Insurance Fund Parity Act] altered but did not eliminate the membership requirement to obtain share insurance. Accordingly, if the law firm or escrow

⁷ 12 C.F.R. §745.14(b).

⁸ This manner of satisfying the membership requirement is remarkable because, with few exceptions outside of the IOLTA and other similar escrow account context, the membership requirement is satisfied in the opposite manner. Specifically, in almost all other contexts, the membership status of the principal, as the true owner of the funds, is the key to obtaining insurance coverage and the membership status of the agent is irrelevant.

⁹ Whether the subject 529 Account SECU has described is eligible for pass-through share insurance coverage depends on its status as an other similar escrow account. Insurance coverage is available on a pass-through basis provided the account also is in compliance with all other relevant provisions of Part 745 of the NCUA's regulations and other applicable law.

¹⁰ 80 FR 80635, 80639-40 (Dec. 28, 2015).

agency itself does not qualify for membership in a particular credit union, but one of its lawyers or agents does, then the firm or agency may maintain an account in that credit union if the eligible lawyer or agent joins the credit union. It is the responsibility of the law firm or other entity wishing to establish an IOLTA or similar escrow account, however, to first determine if state and other applicable law and rules of professional conduct allow for such an arrangement.¹¹

Provided the membership requirements as discussed above are satisfied, namely that the Foundation and the Authority are members of SECU, in accordance with applicable law and rules of professional conduct, then the subject 529 Account satisfies this element of the definition of “other similar escrow account.”

(2) Serving in a Fiduciary Capacity

The second element of the definition of “other similar escrow account” that must be satisfied includes whether the account holder is “serving in a fiduciary capacity.” As mentioned above, state law generally governs in this area. SECU has represented that: (1) a Participant is the beneficial owner of a 529 deposit; (2) a 529 deposit held by the Authority must be held in trust for the Participant; and (3) the laws of the State of North Carolina provide that the trustee relationship between the Participant and the Authority, and its agent, the Foundation, is a fiduciary relationship among the parties. Presuming the legal and factual accuracy of SECU’s representations, the fiduciary capacity requirement of the definition of “other similar escrow account” is satisfied.

(3) Transaction or Business Relationship

The third element of the definition of “other similar escrow account” requires that the account holder/agent “hold[] funds for the benefit of a client or principal as part of a transaction or business relationship.” As noted above, SECU has represented that the Program was created under the laws of the State of North Carolina to be a qualified tuition program under Section 529 of the Internal Revenue Code to enable qualified parents and other interested parties to save funds to meet the costs of postsecondary education expenses of eligible students. This structure satisfies the transaction or business relationship element of the definition of “other similar escrow account.”

Other Share Insurance Requirements

Although the subject 529 Account satisfies all of the elements of the definition of “other similar escrow account,” to be fully eligible for coverage, the subject 529 Account must also comply with other applicable law. For instance, the recordkeeping requirements in §745.2(c)(1)-(2) of the NCUA’s regulations are particularly relevant. These requirements are summarized in the Guidance:

¹¹ NATIONAL CREDIT UNION ADMINISTRATION, NCUA OFFICE OF GENERAL COUNSEL’S GUIDANCE ON ENHANCED SHARE INSURANCE 3-4 (2016), available at <https://www.ncua.gov/regulation-supervision/Documents/Regulatory%20Alerts/RA2016-02-enclosure.pdf>.

Section 745.2(c)(1) of NCUA's regulations provides that "the account records of an insured credit union shall be conclusive as to the existence of any relationship pursuant to which the funds in the account are deposited and on which a claim for insurance coverage is founded." NCUA will not recognize a claim for insurance based on such a relationship in the absence of such disclosure. Additionally, §745.2(c)(2) provides that "if the account records of an insured credit union disclose the existence of a relationship which may provide a basis for additional insurance, the details of the relationship and the interests of other parties in the account must be ascertainable either from the records of the credit union or the records of the member maintained in good faith and in the regular course of business." IOLTAs and escrow accounts are the kinds of accounts that are based on a relationship upon which a claim for insurance coverage could be founded. As such, for these accounts to receive pass-through coverage, the recordkeeping provisions of §745.2(c)(1)-(2) must be satisfied. NCUA did not impose any new recordkeeping requirements in the 2015 share insurance rule.¹²

It is important to note that, for share insurance purposes, a Participant's funds in the subject 529 Account and any other funds the Participant happens to have in another account at SECU could be aggregated and insured pursuant to Part 745 of the NCUA's regulations only to the standard maximum share insurance amount (\$250,000) depending on the legal capacity in which the Participant owns the various accounts.

Summary

To summarize, based on SECU's representations of the facts and North Carolina State law, the subject 529 Account at SECU satisfies the definition of an "other similar escrow account" and is eligible for pass-through share insurance coverage. Actual insurance coverage depends, as always, on compliance with all other applicable law.

Sincerely,

Michael J. McKenna
General Counsel

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¹² NATIONAL CREDIT UNION ADMINISTRATION, NCUA OFFICE OF GENERAL COUNSEL'S GUIDANCE ON ENHANCED SHARE INSURANCE 6 (2016), available at <https://www.ncua.gov/regulation-supervision/Documents/Regulatory%20Alerts/RA2016-02-enclosure.pdf>.