

NCUA Office of General Counsel's Guidance on Enhanced Share Insurance

Effective January 27, 2016

The Credit Union Share Insurance Fund Parity Act (Insurance Parity Act) amended the Federal Credit Union Act (FCU Act) to require NCUA to provide enhanced, pass-through share insurance coverage for: 1) Interest on Lawyers' Trust Accounts (IOLTAs); and 2) "other similar escrow accounts." Accordingly, in December 2015, the NCUA Board amended its share insurance rules (12 C.F.R. Part 745) to reflect these statutory amendments.

The purpose of this guidance is to clarify: 1) what an IOLTA is; 2) what "other similar escrow accounts" are; 3) what pass-through insurance is; 4) how the new rule works; 5) how prepaid cards are treated; and 6) how the provisions of the new rule interact with those share insurance provisions in Part 745 that were not revised in December 2015.

I. Background

A. What is an IOLTA?

Various states operate IOLTA programs pursuant to their own laws. Under an IOLTA program, an attorney or law firm may establish an account at one or more financial institutions to hold their clients' funds to pay for legal services or for other purposes. An attorney or a law firm would deposit clients' funds in one or more IOLTAs and hold these funds in trust until needed. Typically, the interest or dividends on IOLTAs are donated to charities or other 501(c)(3) tax exempt organizations and used to subsidize legal aid services or for other charitable purposes.

B. What are "Other Similar Escrow Accounts"?

"Other similar escrow accounts" are escrow accounts that are similar enough to IOLTAs in structure and function to be eligible for the same kind of enhanced pass-through share insurance coverage now available for IOLTAs. In NCUA's 2015 share insurance rule, a similar escrow account is defined as "an account where a licensed professional or other individual serving in a fiduciary capacity holds funds for the benefit of a client as part of a transaction or business relationship." 12 C.F.R. 745.14(c)(ii).

C. What is Pass-through Insurance?

The Insurance Parity Act and NCUA's share insurance rules define "pass-through share insurance," with respect to IOLTAs and other similar escrow accounts, as "insurance coverage based on the interest of each person on whose behalf funds are held in such accounts by the attorney administering the IOLTA or the escrow agent administering a similar escrow account." The basic idea of pass-through share insurance is that the share

insurance coverage flows through the party in whose name the account is opened to the true owner of the funds. In the case of an IOLTA or other similar escrow account, the share insurance would flow through the attorney or escrow agent who opened the account to the true owners of the funds, namely the attorney's or the escrow agent's clients and principals.

II. How Does the 2015 Share Insurance Rule Work?

A. Overview

Prior to the enactment of the Insurance Parity Act and NCUA's 2015 share insurance rule, the FCU Act limited the pass-through coverage NCUA could provide on IOLTAs and escrow accounts. Specifically, coverage was subject to the FCU Act's general limitation to insure only member accounts. This meant that NCUA could only provide pass-through coverage to those clients of an attorney or principals of an escrow agent who also were members of the federally-insured credit union (FICU) in which the subject IOLTA or escrow account was kept. The clients' and principals' status as members is what satisfied the FCU Act's membership requirement for share insurance. Non-member clients and principals were not insured. Many FICUs maintained that this placed them at a competitive disadvantage with banks.

The Insurance Parity Act and NCUA's 2015 share insurance rule have removed any such disadvantage by allowing the membership requirement necessary for insurance to be satisfied by the lawyer or escrow agent instead of the client or principal. In other words, if the lawyer or escrow agent is a member of the FICU in which the account is held, then the membership requirement is satisfied and the membership status of the client or principal is irrelevant. Provided the lawyer administering the IOLTA or the escrow agent administering a similar escrow account is a member of the FICU in which such account is maintained, then the interests of each client or principal, on whose behalf funds are being held in such account, will be insured on a pass-through basis in accordance with the insurance limits of Part 745 of NCUA's rules. This is regardless of the membership status of the client or principal, who is the true owner of the funds.

However, the Insurance Parity Act only granted NCUA the authority to provide pass-through insurance on a limited number of categories of accounts. Specifically, the only accounts that qualify for the enhanced pass-through coverage under the 2015 rule are IOLTAs and other escrow accounts that are similar to IOLTAs. The enhanced coverage permitted by this shift in membership focus from the client or principal to the attorney or escrow agent represents a rare departure from the FCU Act's general requirement that share insurance coverage be provided only to the true owner of account funds who is also a member of the credit union. It is clear that Congress intended for all IOLTAs to receive this special treatment, but limited this special treatment only to those other escrow accounts that are "similar" to IOLTAs.

B. Enhanced Pass-Through Coverage for “Other Similar Escrow Accounts”

As noted above, in addition to enhanced pass-through coverage for IOLTAs, the Insurance Parity Act also makes enhanced pass-through insurance available for other kinds of escrow accounts that are similar to IOLTAs. NCUA defines an “other similar escrow account” as “an account where a licensed professional or other individual serving in a fiduciary capacity holds funds for the benefit of a client as part of a transaction or business relationship.” 12 C.F.R. 745.14(c)(ii).

In crafting this definition, NCUA recognized that there are some escrow accounts whose nature and structure are immediately recognizable as similar to an IOLTA. For example, real estate escrow accounts and prepaid funeral accounts are similar to IOLTAs, and, therefore, entitled to pass-through share insurance coverage under the revised membership requirements of the 2015 share insurance rule.

One of the signature characteristics common to these accounts and IOLTAs is that each has a licensed professional or other individual serving in a fiduciary capacity and holding funds for the benefit of a client as part of some transaction or business relationship. There are many escrow accounts currently in use that are similar to IOLTAs and entitled to the enhanced pass-through insurance contemplated by the Insurance Parity Act. However, it is difficult to devise a one-size-fits-all description appropriate for all of those escrow accounts. There is a lack of uniformity in language, function, and organizational structure associated with escrow accounts especially from jurisdiction to jurisdiction that makes it difficult for NCUA to identify by name which escrow accounts are eligible for enhanced share insurance coverage. As such, NCUA will provide enhanced share insurance coverage on these escrow accounts, in addition to real estate escrow accounts and prepaid funeral accounts, on a case-by-case basis, regardless of what the accounts are called provided such escrow accounts satisfy the regulatory definition of “other similar escrow account.”

If credit unions are unsure whether a particular escrow account is entitled to enhanced share insurance coverage, they may contact NCUA for help in making that determination. Over time, NCUA will help credit unions better identify these accounts and will make that information public in order to provide other credit unions with more regulatory certainty.

C. Who May Open IOLTAs and Other Similar Escrow Accounts?

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 Insurance Parity Act altered but did not eliminate the membership requirement to obtain share insurance. Accordingly, if the law firm or

escrow 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.

D. What about Prepaid Cards Including Payroll Cards?

1. Under The New Provisions Of The 2015 Share Insurance Rule

Any account that satisfies NCUA's definition of "other similar escrow account" is entitled to enhanced pass through share insurance coverage under the Insurance Parity Act and NCUA's 2015 share insurance rule. That includes prepaid card programs. However, NCUA's research demonstrates that the prepaid card programs NCUA has identified, including payroll cards, do not currently satisfy that definition. Therefore, they are not escrow accounts similar to IOLTAs for share insurance purposes and are not entitled to receive enhanced pass-through coverage.

The characteristics that define an attorney's relationship with, and the fiduciary duties owed to, the attorney's clients are typically not present in the prepaid card scenario. An IOLTA and a prepaid card program serve drastically different purposes and typically have significantly different structures. However, NCUA's 2015 share insurance rule does not absolutely prohibit prepaid cards from receiving the enhanced coverage. Rather, if a credit union can identify an existing prepaid card program that satisfies the definition of "other similar escrow account" or if such a product is created in the future, then NCUA would insure it under the provisions of the 2015 share insurance rule.

2. Under NCUA's Share Insurance Rules That Were Not Affected by the 2015 Share Insurance Rule

Prior to the enactment of the Insurance Parity Act, NCUA insured IOLTAs and escrow accounts using the traditional membership analysis discussed above. Namely, that it is the membership status of the actual owners of the funds (the clients or principals), not the attorney or escrow agent, that matters for share insurance purposes. This analysis is still used to provide insurance coverage for those accounts that do not qualify for enhanced coverage under the new provisions introduced by the Insurance Parity Act. The two methods of providing insurance coverage coexist and both continue to be available depending on the nature of the account.

Accordingly, under certain circumstances, some prepaid card programs may be entitled to pass-through share insurance coverage under the provisions in Part 745 that existed before the enactment of the Insurance Parity Act and are unrelated to IOLTAs. In brief, if funds in a prepaid card program deposited in a FICU qualify as a share account that can be traced back to a specific owner in a specific dollar amount,

and the owner is a member of the credit union where the funds are kept, then those funds would be entitled to share insurance pursuant to provisions in Part 745 that existed before the enactment of the Insurance Parity Act and are unrelated to IOLTAs. See Appendix 1 for a more detailed explanation of this analysis.

E. Does the 2015 Share Insurance Rule Eliminate Any Share Insurance Coverages?

As discussed above, the enhanced pass-through share insurance coverage offered as a result of the Insurance Parity Act and NCUA’s 2015 share insurance rule is in addition to coverage that already existed and continues to exist in other provisions of NCUA’s share insurance rules. As a result, no coverages that previously existed have been eliminated or diminished in any way. Accordingly, certain accounts such as IOLTAs and escrow accounts could be covered under the old provisions of Part 745 or the 2015 revised provisions of Part 745 depending on how the account might satisfy the FCU Act’s membership requirements.

Pass-Through Share Insurance Coverage Change Summary

ACCOUNT TYPE ↓	Coverage under the old share insurance rules (which continue in effect and coexist along with the new rule for IOLTAs and other similar escrow accounts)* ↓	Coverage under the <u>new</u> rule for IOLTAs and other similar escrow accounts* ↓
IOLTAs	Pass-through coverage for the client only if the client is a member of the credit union. Attorney’s membership status is not determinative.	Pass-through coverage for all clients, so long as the attorney is a member of the credit union. Clients’ membership status is not determinative.
ESCROW ACCOUNTS	Common escrow accounts not similar to IOLTAs: Pass-through coverage for the client only if the client is a member of the credit union. Escrow agent’s membership status is not determinative.	Other similar escrow accounts: Pass-through coverage for all clients, so long as the escrow agent is a member of the credit union. Clients’ membership status is not determinative.
REAL ESTATE ESCROW ACCOUNTS	Pass-through coverage for the client only if the client is a member of the credit union. Escrow agent’s membership status is not determinative.	Pass-through coverage for all clients, so long as the escrow agent is a member of the credit union. Clients’ membership status is not determinative.

PREPAID FUNERAL ACCOUNTS	Pass-through coverage for the client only if the client is a member of the credit union. Escrow agent's membership status is not determinative.	Pass-through coverage for all clients, so long as the escrow agent is a member of the credit union. Clients' membership status is not determinative.
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*All accounts must meet the recordkeeping requirements of §745.2(c)(1)-(2) to receive insurance coverage.

F. Are There Any Other Requirements to Obtain Pass-Through Coverage?

1. Record Keeping Requirements

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.

III. What Else Should Credit Unions Be Aware Of?

A. Bank Secrecy Act Implications

The enhanced share insurance coverage provided by the Insurance Parity Act does not affect the Bank Secrecy Act (BSA) requirements of FICUs. However, NCUA reiterates that FICUs continue to have the same BSA responsibilities with respect to IOLTAs and other similar escrow accounts. NCUA emphasizes the importance of continued BSA compliance given that these kinds of accounts may contain funds of nonmembers, who are likely not known by the credit unions in which the accounts are kept.

B. Limits On Receipt Of Payments On Shares From Nonmembers Under §701.32

The Insurance Parity Act provides that if the attorney administering an IOLTA or the escrow agent administering a similar escrow account is a member of the credit union in which the funds are held, then the account will be considered a member account. Accordingly, funds in those member accounts do not count towards the limit on the receipt of payments on shares from nonmembers under §701.32.

IV. NCUA Contact Information

For further information contact NCUA's Office of General Counsel at (703) 518-6540.

Appendix 1 - Prepaid Cards

General Statement

NCUA has been asked if prepaid cards are insured by the National Credit Union Share Insurance Fund (NCUSIF) even if they do not qualify as “other similar escrow” accounts as defined in NCUA’s 2015 share insurance rule. NCUA also has been asked if it analyzes this issue similarly to the Federal Deposit Insurance Corporation’s (FDIC) analysis in FDIC General Counsel’s Opinion No. 8 on the insurability of prepaid cards, which are also referred to as stored value cards.¹ Under certain circumstances, as discussed in more detail below, prepaid cards that evidence shares in a member account² held for the benefit of a member in an NCUSIF-insured credit union are insured by the NCUSIF up to applicable limits even if they do not qualify as “other similar escrow” accounts as defined in NCUA’s 2015 share insurance rule. Our analysis in reaching this conclusion is substantially similar to the analysis used in the referenced FDIC opinion. A key difference in our analysis from the FDIC’s, however, is that NCUA must take credit union membership into account, and the FDIC does not.

Share Insurance Coverage

One of NCUA’s fundamental functions is to insure member accounts at FICUs. Particularly relevant to the determination of whether to insure prepaid cards is the meaning of “member account” and a determination of who the member account holder is.

The FCU Act defines a “member account” as:

a share, share certificate, or share draft account of a member of a credit union of a type approved by the Board which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member...³

NCUA’s share insurance regulations further provide that all types of member share accounts received by a credit union in its usual course of business, including regular shares, share certificates, and share draft accounts, represent equity and are insured.⁴

The share insurance regulations also address deposits by one party that are “owned” by another party. Specifically, the regulations provide that the account records of a FICU are conclusive as to the existence of any relationship pursuant to which the funds in an account are deposited and on which a claim for insurance coverage is founded. Further, no claim for insurance based on a relationship such as a trustee, agent, custodian, or executor will be recognized in the absence of such disclosure.⁵

¹ FDIC General Counsel’s Opinion No. 8, 74 Fed. Reg. 67155 (November 13, 2008).

² The term “member account” is defined in 12 U.S.C. §1752.

³ 12 U.S.C §1752(5).

⁴ 12 C.F.R. §745.0.

⁵ 12 C.F.R §745.2(c).

If a credit union's records disclose the existence of a relationship, which may provide the basis for insurance coverage, the details of the relationship and the interest of other parties in the account must be ascertainable from the credit union's records or the records of the member maintained in good faith and in the regular course of business.⁶ In instances of a properly documented relationship, share insurance coverage will pass through the nominee to each of the actual owners of the account in accordance with NCUA's share insurance rules. When these conditions are not met, NCUA will treat the custodian (i.e., the named account holder) as the owner of the funds for share insurance purposes.

Prior to the enactment of the Insurance Parity Act and promulgation of NCUA's 2015 share insurance rule, NCUA would consider three key questions in determining the share insurance coverage of a prepaid card. These questions are: 1) does the prepaid card represent a member account? 2) if so, who is the actual owner of the account for share insurance purposes and in what dollar amount? and 3) is the owner a member of the credit union in which the funds are deposited. Since the enactment of the Insurance Parity Act and promulgation of NCUA's 2015 share insurance rule, a fourth question has become relevant. Specifically, does the prepaid card satisfy the definition of "other similar escrow account" as defined in NCUA's 2015 share insurance rule?

If the answer to this fourth question is "yes," then the prepaid card would be covered under the 2015 share insurance rule. If the answer is "no," then the prepaid card is not covered under the 2015 share insurance rule, but it may be covered under other provisions of NCUA's share insurance regulations based on an analysis of the first three questions noted above.

The below analysis of whether coverage exists for a prepaid card presumes that a prepaid card does not qualify for coverage under the 2015 share insurance rule as an "other similar escrow account." We make this presumption because: 1) NCUA's research indicates that prepaid cards the agency has identified generally will not satisfy the definition of "other similar escrow account;" and 2) NCUA is highlighting how such prepaid cards may still be insured by provisions of NCUA's share insurance rules that were not affected by the 2015 share insurance rule.

Analysis

As noted above, the first step in NCUA's share insurance analysis of prepaid cards that do not satisfy the definition of "other similar escrow account" is to determine if the prepaid card is or represents a member account for share insurance purposes. We conclude that a prepaid card that permits access to funds on deposit at a FICU does constitute, at least initially for purposes of this first step of the analysis, a member account. Consistent with FDIC's view in FDIC General Counsel's Opinion No. 8, we perceive no legal distinction, for share insurance purposes, between such a prepaid card and other access devices such as share drafts, money orders, or debit cards. All of these devices are a means to access funds deposited in a credit union in its normal course of business.

In reaching this conclusion, we considered the characteristics of this kind of prepaid card in relation to the FCU Act's definition of "member account." As discussed above, the FCU Act

⁶ Id.

broadly defines “member account” as “including money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member...”⁷

Having satisfied the first step in the analysis, the next step is that NCUA determines who qualifies as the account holder for share insurance purposes and in what dollar amount. In other words, NCUA determines who owns the money on deposit with the credit union. In this context, any share insurance coverage would “pass through” the distributor of the prepaid card to the cardholder owner of the money if: 1) the account records of the credit union identify the existence of an insurable custodial relationship between the prepaid card distributor and the cardholder; and 2) the records of the credit union or those maintained by the prepaid card distributor reflect the identity of the cardholders and the specific amount of money owned by each cardholder owner.

In the case of a prepaid card as described above, the distributor typically deposits money at a credit union and then has cards issued in the names of the individual cardholders. For example, if an issuer deposits \$30,000 into an account at a credit union and issues a prepaid card to X for \$9,000, Y for \$1,000, and Z for \$20,000, and the credit union’s records reflect this custodial relationship, and it is ascertainable from the appropriate records how much each individually identified person is entitled to, then X, Y, and Z would be considered the account owners for share insurance purposes. Provided the final step in the coverage analysis regarding membership is satisfied, then X, Y, and Z each would be insured up to \$250,000 on a pass-through basis.

As alluded to above, the final step in the share insurance analysis is to determine which, if any, of the individual cardholder owners of the funds are members of the credit union in which the money is deposited. Under the FCU Act, only accounts of members qualify for share insurance coverage.⁸ If a cardholder owner of the funds is not a member of the credit union in which the money is on deposit, then that individual is not entitled to share insurance coverage. The amount of money attributable to that person would be considered owned by the depositing card distributor and insured in accordance with NCUA’s share insurance rules. In the example above, if X and Y are not members of the credit union in which the money is on deposit, then the amount attributable to them would be treated as owned by the depositing card distributor and not insured if the card distributor is also not a member. Member Z would still be fully covered.

⁷ 12 U.S.C. §1752(5).

⁸ The FCU Act and NCUA’s share insurance rules provide for limited instances where certain kinds of nonmember accounts are eligible for share insurance coverage. 12 U.S.C. §1752(5); 12 C.F.R §745.1.