

Comments from the Washington Bankers Association (WBA) and the Washington Independent Community Bankers Association (WICBA)

March 15, 2007

Ms. Linda Jekel
Director of Credit Unions
Department of Financial Institutions
P.O. Box 41200
Olympia, WA 98504-1200

Re: Alternative Share Insurance Draft Regulations – Informal commentary

Dear Ms. Jekel:

Thank you for providing us the opportunity to comment on the Division of Credit Union's (the "DCU") proposed draft of the Alternative Share Insurance Regulations (the "[Draft](#)") dated February 12, 2007, OTS-9542.1. As you are aware, we represent the Washington Bankers Association ("WBA") and the Washington Independent Community Bankers Association ("WICBA") and provide these comments on their behalf. Meeting the expectations of the depositing public is an issue that concerns all depository institutions so a proposal that may put depositors' money at risk is a common concern to all of us. As articulated more specifically below, we have many concerns not only regarding the substance of the Draft but the process proposed for its consideration. We ask you to adopt our recommendations; in the alternative, we request that you substantially revise the [timeline](#) for this project as proposed in DCU's release of the [CR-101](#) dated June 30, 2006 to allow for greater stakeholder participation.

Substantive Concerns

[RCW 31.12.408\(1\)](#) provides for an alternative share insurance program that is equivalent to federal insurance provided that the alternative (a) holds reserves proportionately equal to the federal share insurance program; (b) maintains adequate reserves and access to additional sources of funds through replenishment features, reinsurance, or other sources of funds; and (c) has share insurance contracts that reflect a national geographic diversity.

1. There is no requirement in the Draft that an applicant prove "proportionately equal reserves".

Although there is a general statement in the Draft that an applicant must meet the statutory standards in RCW 31.12.408, see the introductory paragraph in WAC 208-800-100, we can find no further reference to the requirement in the list of information that an applicant must provide in that section -100. Therefore there is no directive for the applicant to document satisfaction of this statutory requirement.

We recommend that -100 be amended to require the applicant to disclose its reserves, the manner in which they are calculated and a justification for how the reserves are "proportionately equal" to the federal fund.

2. There is no requirement in the Draft that an applicant document that it has "adequate reserves" as that term is defined in -030.

We note that the term "adequate reserves" is defined in -030 yet the term is not used throughout sections -030 through -400 and therefore there is no requirement for the applicant to document compliance with the statutory standard. We applaud the definition, especially since it calls for reserves "with the highest available level of safety for share accounts". Superlatives such as "highest" are prudent when protecting the safety of Washington

wage earners' deposits. Unfortunately, the standard is nowhere articulated in the rule and therefore we cannot express a complete opinion about its merit.

We recommend that the rules require reserves commensurate to the inherent risk in the fund. This should be a very high standard given that currently members' deposits are fully protected by the full faith and credit of the United States government.

3. There is no requirement in the Draft for an applicant to document that it has “replenishment features” and “additional sources” as those terms are defined in -030.

Here again, we note that the term “replenishment features” and “access to additional sources of funds” are defined in -030 yet the terms are nowhere to be found throughout sections -030 through -400. These omissions are especially troublesome since it is the replenishment features and access to other sources of funds of federal deposit insurance that provide it its greatest strength and its greatest protection to depositors. Federal deposit insurance is backed by the full faith and credit of the United States government. Since its inception in the 1930s, no federally insured depositor has lost money as a result of a federally insured bank, thrift or credit union failure because of this replenishment feature. Unfortunately, the same thing cannot be said for private deposit insurance coverage where there are numerous documented cases of spectacular failures, the specifics of which are beyond the scope of this commentary, where insured depositors have lost money or have been denied access to their accounts during extended workout periods. We note that -100 requires documentation of reinsurance and “other sources of funds” yet neither term address the issues of “replenishment” and “additional sources” as defined.

We recommend that -100 be amended to require an applicant to detail the manner in which its reserves can be supplemented by “replenishment” features and by “additional sources.” We also recommend that these features should be equivalent to the replenishment features in a federal share/deposit insurance program.

4. The proposed test for “national geographic diversity” does not meet the standard for judicial review in RCW 34.05.570[1][1].

The statute requires the applicant to have “share insurance contracts that reflect a national geographic diversity.” The purpose of this rule is to test the geographic diversity of the fund under the theory that a more broadly geographically dispersed fund would be less likely to fail than one that is concentrated in a single region. In order to affect the legislative purpose of this requirement, the more geographic regions in the test the better. However, DCU uses quite the opposite approach. The test for national geographic diversity does not use any type of geographic divisions that is even remotely related to the financial services industry nor does it take into consideration the disparate densities in different regions of the country. Instead the DCU proposes to use as a test, time zones, and for no explicable reason combines the Pacific Time Zone with the Mountain Time Zone, nearly half the geographic region of the continental United States. The problem is compounded by allowing the use of share insurance contracts that are not relevant to primary share insurance. Under proposed rule -800-100(12)(e) the applicant need only document a “distribution of contracts” among three regions of the country -- Pacific/Mountain, Central and Eastern Time Zones. This requirement does not limit the documentation to primary insured contracts and presumably could include excess share insurance (“ESI”) coverage as well. Not only is the use of time zones irrational but the inclusion of ESI numbers in the documentation inflates the numbers and dilutes the geographic test even further. The apparent attempt to manipulate the standard appears so blatant that we are left to wonder if the proposed rules are designed to accommodate a particular applicant rather than to test whether a particular applicant can qualify under the rules. This exuberance appears to follow through in the [Bulletin](#) of February 12, 2007 where a promise of a private deposit insurance option is at least implied “as early as 2008.”

We note in your [cover letter](#) to the CR101 of July 3, 2006 that the Department was approached by five credit unions and the Credit Union League to “inquire about whether the Department would allow credit unions in this state to be insured by a private insurer.” It appears to us that perhaps more than an inquiry took place and we

wonder if this procedure should be promulgated under [RCW 34.05.330](#) and [WAC 82-05](#) instead of under departmental rulemaking authority.

We recommend (i) the use of the [12 Federal Reserve Districts](#) as a better division of the country for the geography test than three time zones and that (ii) the test should be exclusively for primary share insurance and not include ESI.

5. The following is a brief non-comprehensive list of other concerns and issues.

- There is no provision for what part of the applicant's record is available for public inspection.
- There is no provision outlining the governance procedures in which a credit union would apply or qualify for private insurance. For example, will the DCU require a vote of the membership and if so, should it be a super-majority?
- There is no provision requiring the applicant to forebear from the use of names that may reasonably mislead the depositing public that the insurance fund is backed by the local, state or federal government or an entity thereof. Such terms as "Washington" (or any other state), "federal", "United States", "America" or any derivatives thereof should be expressly prohibited.

Process Concerns

[RCW 31.12.408\(2\)](#) requires that before Washington Credit Unions can avail themselves of an alternative share insurance program, "the director must make a finding that the alternative share insurance program meets the standards set forth (above), **following a public hearing and a report on the basis for such finding to the appropriate standing committees of the legislature.** All such findings shall be made before December 1st of any year and shall not take effect until the end of the regular legislative session of the following year." (Emphasis added.)

1. The process proposed by the DCU might very well deprive the financial institutions standing committees of the legislature of its appropriate oversight role in the approval process of an applicant.

There is an ambiguity in the statute concerning the phrase "following a public hearing". The DCU interprets this requirement as an administrative hearing. It could also be interpreted as a legislative hearing depending upon whether the intent of the writer was to explain the legislative involvement after the comma in that sentence. Arguably that was in fact the intent of the writer if the legislative history is reviewed. In the [Senate Bill Report to SSB 6579](#), page 2, the second-to-the-last paragraph, the author divides the process into two sentences:

Before any credit union can insure in an equivalent program, the Director of the Department of Financial Institutions must make a finding that the alternative program meets the standards set forth in the bill. This finding must follow a public hearing and report on the basis for the finding to appropriate standing committees of the Legislature.

It appears to us that the author has articulated the administrative process in the first sentence and articulated the Director's legislative responsibilities in the second sentence; otherwise, the requirement for a public hearing would appear in the first sentence.

We acknowledge, however, that reasonable minds may differ on this interpretation. Given the ambiguity, we recommend that DCU undertake a conservative approach to the provision and alter its process to include both parts of the ambiguity, conduct an administrative hearing and work with the standing committees for a public hearing and a report on the administrative findings. This would leave no doubt about the legislature's role in the process. All of this, of course, would have to occur prior to December 1 of any year of the application.

2. As for the rulemaking process itself, the proposed schedule allowing for only the statutory minimum of 20 days between the filing of the CR102 and a public hearing, is too short for a process of this importance to the financial services industry in Washington.

We commend the DCU for starting the process early by filing the [CR101](#) that started this rulemaking process last year on June 30, 2006. However, the first draft of the rule was not available for public comment until February 12, 2007. Given the non-exclusive list of concerns as articulated in this letter, along with other possible concerns of other commentators, we believe that the process must be much more inclusive and much more deliberative. We respectfully request that the DCU postpone the public hearing date for 90 days so all interested parties can have the opportunity to review the proposed final.

3. The draft rules are inconsistent with the Governors Executive Order 05-03.

[Governors Executive Order 05-03](#) requires all agencies to draft documents using Plain Talk principles. The DFI has already implemented this requirement in its rulemaking activities in other divisions like the Division of Consumer Services. The format proposed by this rule is inconsistent with the format used by that division. See for example, the [mortgage broker rules](#) in WAC 208-660.

The legislative mission of the DCU is articulated in RCW [31.12.015](#) and includes as its primary mission “to protect members' financial interests”. All other articulated missions for the DCU must be subordinate to this mandate. Probably most disturbing about this process is the lack of a justification for raising this issue in the first place, especially in light of the fact that there is no explicit directive from the legislature to promulgate rules. The record seems to indicate that the purpose of the rulemaking process is because five credit unions and one trade association asked for it. The Draft seems to admit that alternatives to federal insurance place members’ deposits at greater risk because the Draft attempts to exculpate the state from any liability arising from such losses. See, Proposed New Section 208-800-400. It would appear to us that the DCU and the Director of the Department should articulate in the final rule why this option will protect members’ financial interests better than the status quo and under what authority rulemaking is justified.

We thank you for this opportunity to provide you with our preliminary view of the proposed rules.

Very truly yours

John L. Bley
representing the WBA and WICBA