



WASHINGTON, D.C.
99 M St. SE
Suite 300
Washington, D.C. 20003-3799
Phone: 202-638-5777
Fax: 202-638-7734

January 22, 2018

ATTN: Comments/ RIN 3133-AE87

Mr. Rob Robine, Trial Attorney
Office of the General Counsel
National Credit Union Administration
1775 Duke Street
Arlington, VA 22314

Re: RIN 3133-AE87
Fidelity Bonds Proposed Rule

Dear Mr. Robine:

By protecting against the loss of money or other tangible property that is incurred as a result of a dishonest act by an employee or other specified person, fidelity bonds play a critical role in stemming the operational risks that credit unions face. In March of 2017, the National Credit Union Administration (NCUA) established a Regulatory Reform Task Force to oversee the implementation of the agency's regulatory reform agenda. As part of that process, the task force identified reform of credit unions' fidelity bond and insurance coverage provisions as a Tier 1 priority with high impact.¹ Specifically, the report recommended that, when it comes to fidelity bond requirements, the NCUA should "explore ways to implement the requirements of the [Federal Credit Union] Act in the least costly way possible," and that "NCUA's objective should be to allow a credit union to make a business decision based on their own product and service needs."² The report went on to indicate that, ultimately, the goal was to "effectively reduce the NCUA's involvement in a credit union's operational decisions while remaining consistent with the [Federal Credit Union] Act." It is with these principles in mind that the Credit Union National Association (CUNA) respectfully offers the following commentary on the NCUA's proposed rule to amend its regulations regarding fidelity bonds for corporate credit unions and natural person credit unions. Our comments are on behalf of America's state- and federally chartered credit unions and the more than 115 million members that they serve.

¹ *Second Report of the Regulatory Reform Task Force* at 16, NCUA (December 13, 2018), available at <https://www.ncua.gov/files/agenda-items/AG20181213Item1b.pdf>.

² *First Report of the Regulatory Reform Task Force* at 16, NCUA (August 22, 2017), available at <https://www.ncua.gov/files/board-comments/regulatory-review-notice-2017.pdf>.

CUNA Supports NCUA’s Proposal to Clarify that Coverage for CUSOs Can Be Included in a Credit Union’s Single Fidelity Bond Policy.

12 U.S.C. §1761, et al requires certain credit union employees and appointed or elected officials to obtain and maintain fidelity bond insurance. As part of the NCUA’s implementing regulations of this requirement, 12 CFR §713.3(a) mandates that fidelity bond coverage “[b]e purchased in an individual policy from a company holding a certificate of authority from the Secretary of the Treasury.” As noted in the explanatory comments accompanying the proposed rule, there has been confusion in interpreting how the “individual policy” language affects a credit union’s ability to insure its credit union service organization (CUSO) as part of a single fidelity bond policy. Consistent with NCUA’s 2017 General Counsel opinion on this issue, the NCUA now proposes to add a subsection to section 713 which would state:

The requirement in paragraph (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.³

CUNA applauds the NCUA for its efforts to provide increased clarity to credit unions on this issue. In addition, we welcome the enhanced flexibility provided by both the provision and the Administration’s 2017 General Counsel opinion. Together, they should position credit unions to make coverage decisions that best serve their business interests and the business interests of their CUSOs.

CUNA Believes that NCUA’s Proposal for a Mandatory Option to Extend the Discovery Period is Based on Flawed Underlying Cost Assumptions for Credit Unions.

As acknowledged in the NCUA’s discussion of the proposed rule, “most fidelity bonds provide that the bond’s coverage terminates immediately upon a credit union’s liquidation and that the ability to purchase an additional period to discover loss is at the sole discretion of the insurer.”⁴ NCUA includes a provision in the proposed rule that would require fidelity bonds to include an option for the liquidating agent to purchase coverage in the event of an involuntary liquidation that can extend the discovery period for a covered loss for at least two years after liquidation. In the case of a voluntary liquidation, fidelity bonds would be required to remain in effect, or provide that the discovery period is extended, for at least four months after the final distribution of assets.⁵ The NCUA states that “[t]he Board does not expect this proposed requirement to result in any additional cost or burden on the FICUs. The liquidating agent would bear the cost of

³ 83 FR 59325.

⁴ 83 FR 59322.

⁵ 83 FR 59328.

any extension of a discovery period.”⁶ CUNA believes that NCUA’s cost expectations, in this respect, are fundamentally incorrect.

The proposed rule will require an insurer to add a two-year extension when there is an involuntary liquidation. Insurers do not currently price for the additional risk. Because the amount that an insurer can charge for an extended discovery period is capped by state insurance regulations, there is a significant likelihood that the premiums paid by a liquidating agent will not be able to offset the full costs related to any losses discovered during the extended period. To make up that difference, insurers will be forced to account for the risks associated with the extended discovery period upfront as part of their underwriting and, ultimately, the cost will be shared by all credit union bond policyholders in the form of increased premiums for coverage. Accordingly, before adopting a final rule on this issue, we urge the NCUA to engage in a meaningful analysis weighing the associated cost increases for credit unions in conjunction with the potential for loss savings for the National Credit Union Share Insurance Fund.

CUNA has Concerns with NCUA’s Proposal to Require Board Members to Sign and Approve Fidelity Bond Applications

As part of the proposed rule, the NCUA seeks to establish a new obligation on a credit union’s Board of Directors. Specifically, the proposed rule includes language stating that:

(b) The board of directors, and, if applicable, the supervisory committee 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

According to the NCUA, “the purpose of these requirements is to address the issue of rescission of fidelity 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 may void the policy and not make a payout when losses are discovered.”

CUNA agrees that the NCUA has a responsibility to protect the National Credit Union Share Insurance Fund (NCUSIF) from losses, however, we are troubled by any effort to diminish a credit union’s ability to ensure that those who are responsible for operational functions, such as applying for fidelity bond coverage, are the individuals who are actually best positioned to ascertain the risks pertaining to fidelity bond coverage. Placing the burden to perform an operational task on the volunteers of the credit union is fundamentally inconsistent with the

⁶ *Id.*

⁷ 12 FR 59325.

reform agenda's objective to "effectively reduce the NCUA's involvement in a credit union's operational decisions while remaining consistent with the [Federal Credit Union] Act."

Accordingly, we urge the NCUA to remove this provision from the final rule. Credit unions are best positioned to determine whether management or their Boards have the expertise to sign for and approve fidelity bond coverage applications and renewals, and do so through an existing process that relies on Management to perform the operational task while relying upon the Board to ensure that risk procedures are in place at the institution that actively work to mitigate the potential for claims in the first place.

CUNA Generally Supports NCUA's Bond Form Sunset Provision

The Board is proposing to add a new paragraph (d) to sunset its approval on all bond forms ten years after the form is approved. Under the proposed rule, the ten-year period will begin on the date the Board approves a bond form and will not toll or start over when a bond carrier submits a revision to an approved bond. CUNA shares the NCUA's belief that the ten-year sunset provision will provide a definitive date for when an approved bond form will be reviewed by the Board to determine if it is still in compliance with the NCUA's regulations.

In those instances where the Board undertakes a review of an approved bond form before the end of the ten-year period, however, the Board proposes not to re-start or toll the expiration period and to permit the Board's approval of that form to still sunset ten years from the date the Board issued its original approval. CUNA believes that this aspect of the proposed rule is inconsistent with the reform agenda's objective to ensure that fidelity bond regulations are implemented "in the least costly way possible" because it subjects credit unions to multiple potential reviews and modifications without the full benefit of the ten-year approval period. Accordingly, we urge the NCUA to modify this provision before releasing the final rule.

On behalf of America's credit unions and their more than 115 million members, thank you very much for your consideration of our views. We look forward to working with you to finalize fidelity bond regulations that best serve credit unions and their members and operate in a manner that is consistent with the objectives of NCUA's regulatory reform efforts.

Sincerely,

Mitria Wilson,
Sr. Director of Advocacy and Counsel