Fiscal Note for CDA Rule

Agency:	North Carolina Department of Commerce, Credit Union Division	
Rulemaking Coordinator:	Tony Knox, Deputy Administrator	
The Rule Making Authority:	G.S. 54-109.12(19) and (20)	
Summary of Impact:	State Government	Minimal
	Local Government	No
	Substantial Impact	**Yes, Benefit to the Members/Community**

The Division is proposing adopting the following Rule as a Permanent Rule:

- 04 NCAC 06C .0708 CHARITABLE CONTRIBUTIONS AND CHARITABLE DONATION ACCOUNTS

Purpose

This new rule will only apply to North Carolina state-chartered credit unions. Though these credit unions have the authority to make limited investments pursuant to N.C.G.S 54-109.82, at this time, they are allowed to make riskier investments but only for the sole purpose of funding employee benefit, retirement or deferred compensation plans for employees of the credit union. By allowing state-chartered credit unions to invest in charitable donation accounts (CDAs), state-chartered credit unions will be able to expand their investment opportunities for a different purpose – charitable giving. State-chartered credits unions have statutory authority to make charitable contributions pursuant to 54-109.21(19) and charitable donation accounts pursuant to 54-109.21(20), however, they can only do so subject to rules adopted by the Administrator of the Credit Union Division.

Furthermore, in September of 2013, the National Credit Union Administration (NCUA) approved the use of charitable donation accounts for federally-chartered credit unions. North Carolina state-chartered credit unions and the Carolinas Credit Union League have expressed interest in having the opportunity to invest in charitable donation accounts. The North Carolina Credit Union Division has determined that it is in the public interest, and important to the maintenance of the competitive system of credit unions that state-chartered credit unions are provided the same powers as Federal credit unions operating in North Carolina to invest funds in a charitable donation account to make charitable contributions. Therefore, we are proposing a similar rule to the NCUA Regulation that grants authority for the charitable donation accounts.

Rule Summary

The proposed rule permits credit unions rated CAMEL 1, 2, or 3 to invest up to 5 percent of their net worth in CDAs. The Board of Directors of a credit union seeking to make charitable contributions and donations shall first adopt policies and procedures governing the creation, funding, and management of a CDA. The assets of a CDA must be held in a segregated custodial account, subject to regulatory oversight. A credit union shall distribute a minimum of 51 percent of the CDA's total return to one or more qualified charities no less frequently than every 5 years.

Analysis

Cost to the Credit Union Division

The fiscal impact of the proposed rule is expected to be minimal on the Credit Union Division budget. It will consist of printing cost, postage and training for the examination staff.

Estimated cost for proposed rule changes are expected to be as follows:	
Two hours training x 50.00 per hour x 6 examiners	$600
Reprint 100 copies of the Rules for $2.80 per copy,	$280
Mail 60 copies of the Rules First Class approx. $2.40 per copy, one to each credit union, entity or person on the Interested Party List	$144
Total Cost to Credit Union Division – State Government	$1024

Prior to funding the CDA, the credit union shall send written notice of the type and amount of initial investment to the Administrator. The review of notice submitted will be handled as a normal course of business by the Deputy Administrator. The opportunity cost for the time dedicated to the review of the policies will be as follows:

The estimated number of credit unions that will participate in Charitable Donation Accounts in 2019 will be 4, based on information provided by the Carolinas Credit Union League. Therefore, the Administrator will review the notice for each credit union, dedicating approximately four hours for each credit union at $55 per hour.

The number of credit unions will be 4, so it will be 4hr x $55= $220; $220 x 4 credit unions for year 2019.	$880
The total estimated cost for outside training, inside training, reprinting, and mailings.	$1024
The total cost to the Credit Union Division – State Government.	$1904

The cost to the Credit Union Division for review of credit union notices, mailings, and trainings is estimated at $1904 in 2019 and $220 for each additional credit union that chooses to invest in CDAs in future years.

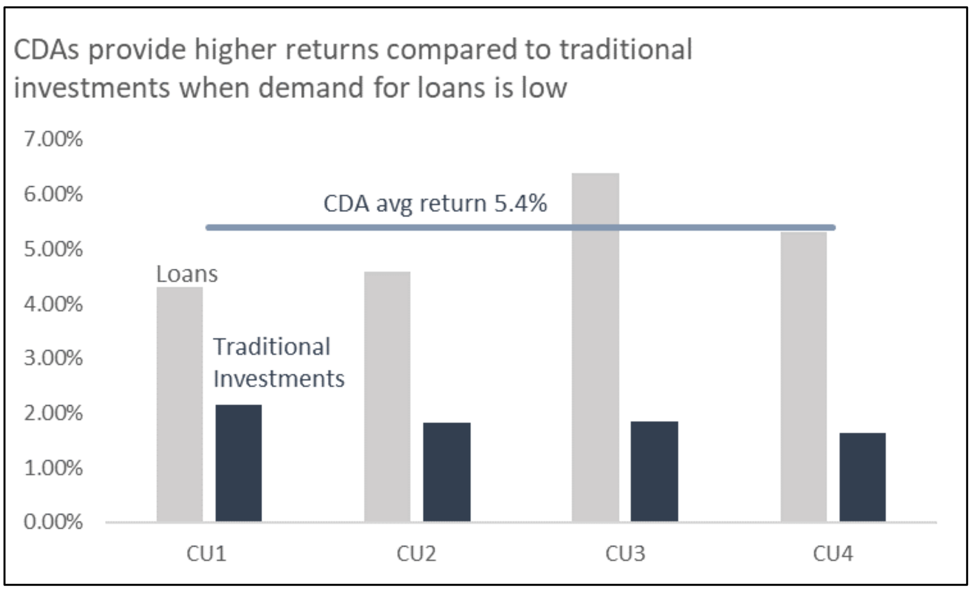
Costs and benefits to the regulated industry and members/ community

The credit unions will be able to increase their investment opportunities with a limited portion of the credit unions' net worth. These investments are expected to equate to additional revenue and profits for the credit union and the charity of their choice in return for taking on higher risk. The chosen charity or charities will receive at least 51% of the total return. As one will observe in the charts in the Analysis section below, many credit unions do well on their traditional earnings on loans. However, there is not always a loan demand, so the credit union would rely on its traditional earnings on investments for additional revenue.

Based on information provided by the Carolinas Credit Union League, there are 4 credit unions that have shown interest in participating in charitable donation accounts. On average, the four credit unions could expect a 0.8% increase in earnings over traditional investments, assuming a 5.4% return on CDAs, an average return of 1.9% on traditional investments, and a charitable distribution of 51% of total earnings. Additional details, data sources, and assumptions are available in Appendix A. Net benefits to credit unions and to charities will vary according to individual investment returns, the size of initial investments, the number of participating credit unions, and charitable distribution rates.

Applying the same assumptions, charities could expect to receive 2.8% of participating credit union earnings, amounting to $160,000 annually from all four credit unions combined.

Furthermore, part of a credit union's mission is to maintain relationships within the community that they serve. In order to maintain that relationship and have a positive impact on community, credit unions contribute to charities that are of interest to their members. Therefore, credit unions will benefit from distributing funds to charities as this will improve a credit union's image with their members and the community at large, leading to more members.



Comparison of CDA and Traditional Investments 4 Credit Unions	**Total Return**	
Credit Union Earnings - Traditional Investments	$ 112,319	1.9%
Credit Union Earnings - CDA (49% of total)	$ 156,854	2.6%
Distribution to Charity (51% of total)	$ 163,256	2.8%
Net Increase in Earnings for Credit Unions Compared to Traditional Investments	**$ 44,535**	**0.8%**

In addition, the participating credit union's board of directors must adopt written policies governing the creation, funding, and management of a CDA. We anticipate this cost will be approximately $2,000 per credit union. Therefore the total one-time cost will be $8,000 for all 4 credit unions.

Alternatives

1. One alternative is not to adopt a rule. Thus, the credit unions would not be able to invest in a CDA. Without a rule, a credit union would not have the risks associated with investing in a CDA; however, there would be none of the added benefit to the credit union or the qualified charity as discussed in the Analysis.
2. A possible other alternative is to increase the minimum percent that a credit union is required to distribute to a qualified charity. This would allow the particular charity to benefit more; however, this would decrease the net increase in earnings for credit unions comparted to traditional investments. A credit union may then reconsider funding a CDA if it meant that they would not see beneficial earnings.

Appendix A – Credit Union Investment Analysis

Credit Union 1

Initial Investment

Net worth	$35,554,339
Maximum Percent	5%
Total aggregate funding	$1,777,717

CDA Return

Total aggregate funding	$1,777,717
Avg. % Return[1]	5.4%
Total Return[2]	$95,997
Total After Distribution[3]	$47,039
Dist. to Charity	$48,958

Credit Union's Traditional Earnings on Loans

Initial Investment	$1,777,717
Yield on Avg. Loans[4]	4.3%
Earnings	$76,442

Credit Union's Traditional Earnings on Investments

Initial Investment	$1,777,717
Yield on Avg. Investments[5]	2.15%
Earnings	$38,221

Credit Union 2

Initial Investment

Net worth	$31,504,173
Maximum Percent	5%
Total aggregate funding	$1,575,209

CDA Return

Total aggregate funding	$1,575,209
Avg. % Return	5.4%
Total Return	$85,061
Total After Distribution	$41,680
Dist. to Charity	$43,381

Credit Union's Traditional Earnings on Loans

Initial Investment	$1,575,209

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[1] The average rates for returns on CDAs over five years is 5.4%, this is based on data provided by a MembersTrustCompany in Florida which does these types of investments.

[2] This is a one year annual return for analysis purposes.

[3] This is assuming credit unions distribute 51% of the total return and keep the other 49%. A credit union has the option to distribute more than just 51%.

[4] The yield on average loans was different for each credit union. Each credit union's information was pulled from NCUA's website. This is also assuming that there is a loan demand.

[5] The yield on average investments was also pulled from NCUA's website.

Yield on Avg. Loans	4.59%
Earnings	$72,302

Credit Union's Traditional Earnings on Investments

Initial Investment	$1,575,209
Yield on Avg. Investments	1.83%
Earnings	$28,826

Credit Union 3

Initial Investment

Net worth	$30,406,283
Maximum Percent	5%
Total aggregate funding	$1,520,314

CDA Return

Total aggregate funding	$1,520,314
Avg. % Return	5.4%
Total Return	$82,097
Total After Distribution	$40,228
Dist. to Charity	$41,869

Credit Union's Traditional Earnings on Loans

Initial Investment	$1,520,314
Yield on Avg. Loans	6.38%
Earnings	$96,996

Credit Union's Traditional Earnings on Investments

Initial Investment	$1,520,314
Yield on Avg. Investments	1.84%
Earnings	$26,453

Credit Union 4

Initial Investment

Net worth	$21,094,575
Maximum Percent	5%
Total aggregate funding	$1,054,729

CDA Return

Total aggregate funding	$1,054,729
Avg. % Return	5.4%
Total Return	$56,955
Total After Distribution	$27,908
Dist. to Charity	$29,047

Credit Union's Traditional Earnings on Loans

Initial Investment	$1,054,729
Yield on Avg. Loans	5.31%
Earnings	$56,006

Credit Union's Traditional Earnings on Investments

Initial Investment	$1,054,729
Yield on Avg. Investments	1.64%
Earnings	$17,298

Appendix B

04 NCAC 06C .0708 is proposed for adoption as follows:

04 NCAC 06C .0708 CHARITABLE CONTRIBUTIONS AND CHARITABLE DONATION ACCOUNTS

(a) A credit union may make charitable contributions and donations or may fund a charitable donation account. The following definitions apply throughout this Rule:

(1) "Charitable contributions and donations" means gifts provided by credit unions to assist others through contributions of staff, equipment, money, or other resources. This definition includes donations to community groups, nonprofit organizations, other credit unions or credit union affiliated causes, political donations, or donations to create charitable foundations.

(2) "Charitable donation account" ("CDA") means a hybrid charitable and investment vehicle that a credit union may fund as a means to provide charitable contributions to qualified charities.

(3) "Qualified charity" means a charitable organization or other non-profit entity that serves either a charitable, social, welfare, or educational purpose, and recognized by section 501(c)(3) of the Internal Revenue Code as tax exempt.

(4) "Total return" means the actual rate of return on all investments in a CDA over a given period of up to 5 years, including realized interest, capital gains, dividends, and distributions, but exclusive of account fees and expenses.

(b) A credit union seeking to make charitable contributions and donations shall adopt policies and procedures as approved by its Board of Directors.

(c) A credit union shall be allowed to fund a CDA only after it has satisfied the following:

(1) Notice. The credit union shall send written notice of the type and amount of initial investment to the Administrator 10 days prior to funding the CDA.

(2) Rating. The credit union shall be rated a CAMEL 1, 2, or 3.

(3) Maximum aggregate funding. The total aggregate investment in CDAs shall be limited to five percent of the applicant credit union's net worth for the duration of the CDAs, as measured every quarterly Call Report cycle.

(4) Segregated account. The assets of a CDA shall be held in a segregated custodial account or special purpose entity and shall be labeled as a CDA.

(5) Regulatory oversight. If a CDA is established using a trust vehicle, the trust shall be a revocable trust and the trustee shall be an entity regulated by a state financial

regulatory agency or a federal regulatory agency. A regulated trustee, other person, or entity that is authorized to make investment decisions for a CDA (manager), other than the credit union itself, shall be either a Registered Investment Adviser with the U.S. Securities and Exchange Commission or regulated by the Office of the Comptroller of the Currency.

(6) CDA documentation and other written requirements. The parties to the CDA shall document the terms and conditions controlling the CDA in a written agreement. The terms of the agreement shall be consistent with this Rule. A credit union's board of directors shall adopt written policies governing the creation, funding, and management of a CDA that are consistent with this Rule, review the policies annually, and may amend them. A CDA agreement and policies shall at a minimum:

(A) provide that the CDA will make charitable contributions and donations only to qualified charities;

(B) document the investment strategies and risk tolerances the CDA trustee or other manager shall follow in administering the account;

(C) provide that a credit union shall account for the CDA, including distributions to charities and liquidation of the CDA, in accordance with generally accepted accounting principles; and

(D) state the frequency with which the trustee or manager of the CDA will make distributions to qualified charities that are consistent with Subparagraph (c)(7) of this Rule.

(7) Minimum distribution to charities. A credit union shall distribute a minimum of 51 percent of the CDA's total return to one or more qualified charities no less frequently than every 5 years.

(d) Upon termination of a CDA, regardless of the length of its term, a minimum of 51 percent of the CDA's total return on assets shall be distributed to one or more qualified charities. Following the distributions to the qualified charities, any remaining assets shall be distributed to the credit union either in cash or shall be distributed to the credit union in kind but only if those assets are permissible investments for State-chartered credit unions as set forth in Rule .1201 of this Subchapter and G.S. 54, Article 14 I.

(e) The Administrator may revoke or modify a previously funded investment to the applicable credit union, if the Administrator finds the previously authorized investment is no longer a safe and sound practice, or has become inconsistent with applicable State or federal law. The Administrator shall send written notice of the revocation or modification to the applicable credit union. A credit union may appeal for a final decision by the Administrator as set forth in Rule 06B .0501 of this Chapter.

History Note: *Authority G.S. 54-109.12; 54-109.21 (19) and (20);*
Eff. April 1, 2019.