

and operates primarily to promote and develop credit unions.

(b) The board of directors must approve charitable contributions and/or donations, and the approval must be based on a determination by the board of directors that the contributions and/or donations are in the best interests of the credit union and are reasonable given the financial condition of the credit union.

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions; Statutory Lien

AGENCY: National Credit Union
Administration (NCUA).

ACTION: Notice of Proposed Rulemaking.

SUMMARY: The NCUA proposes to update, clarify and convert to a regulation the provisions of its existing Interpretive Ruling and Policy Statement ("IRPS"), which implements the Federal Credit Union Act's authority to establish a statutory lien. Like the IRPS, the proposed rule will permit a federal credit union to impress a statutory lien upon the shares and dividends of a member, and to enforce that lien to satisfy the member's outstanding indebtedness to the credit union, even when such indebtedness is not secured by shares.

DATES: Comments must be received on or before January 27, 1999.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428. Fax comments to (703) 518-6319. *Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: Steven W. Wideman, Trial Attorney, Division of Litigation & Liquidations, Office of General Counsel, at the above address or telephone: (703) 518-6557.

SUPPLEMENTARY INFORMATION:

A. Background

Section 107(11) of the Federal Credit Union Act, 12 U.S.C. 1757(11) (hereinafter "*§ 1757(11)*"), provides that a federal credit union "shall have [the] power . . . to impress and enforce a lien upon the shares and dividends of any member to the extent of any loan made to him and any dues or charges payable by him." Beginning in 1979, NCUA took

the position that a federal credit union could enforce the lien granted by *§ 1757(11)* only after it had obtained a court judgment on the debt, unless state law allowed enforcement of the lien without first obtaining such a judgment. NCUA, *Manual of Laws Affecting Federal Credit Unions* 1-17 (6/78 ed.); NCUA, *Credit Manual for Federal Credit Unions* 29 (12/79 ed.). Once the prerequisite judgment was obtained, the credit union could apply the member's shares to his or her outstanding loan balance.

In 1982, NCUA reconsidered this interpretation of *§ 1757(11)* because of experience indicating that it placed credit unions at a disadvantage compared to other financial institutions, which usually can offset a borrower's loan without first obtaining a court judgment. 47 FR 44340 (October 7, 1982). As a result, NCUA issued Interpretive Ruling and Policy Statement No. 82-5 ("IRPS 82-5"), reinterpreting *§ 1757(11)* to authorize a credit union to enforce the lien on the shares and dividends of a member without first obtaining a court judgment against the member, state law to the contrary notwithstanding. 47 FR 57483 (December 27, 1982). The NCUA Board concluded, and still maintains, that the reinterpretation of *§ 1757(11)* is more consistent with Congressional intent.

In 1987, NCUA issued Interpretive Ruling and Policy Statement No. 87-2 entitled "Developing and Reviewing Government Regulations," 52 FR 35231 (Sept. 18, 1987) ("IRPS 87-2"). IRPS 87-2 established the policy of reviewing all existing NCUA regulations every three years for the purpose of updating, clarifying and simplifying them, and eliminating redundant and unnecessary provisions. *Id.* at 35232. Following a plain English question and answer format, the proposed rule is intended to fulfill that purpose.

B. Principal Differences Between IRPS 82-5 and Proposed Rule

The principal difference between IRPS 82-5 and the proposed rule is the requirement in *§ 701.39(b)(1)* and (3) that the credit union give written notice to its member at the time it impresses a statutory lien on that member's account(s). But for such written notice, the member would not necessarily be aware when the credit union impresses a lien either by notation on its records of the member's account(s) or through a duly adopted by-law generally establishing a lien on members' accounts.

The proposed rule also resolves two ambiguities in IRPS 82-5 and recent editions of NCUA's "Examiner's

Guide." See, e.g., NCUA *Examiner's Guide* 9-96 (6/97 ed.). First, the rule reiterates NCUA policy permitting a statutory lien only to offset a member's outstanding indebtedness to the credit union, not to offset other outstanding financial obligations of the member to the credit union. Proposed *§ 701.39(a)(4)*. Second, the rule distinguishes a statutory lien from a share secured loan by emphasizing that until a statutory lien is enforced, following a member's default, the member is permitted to make withdrawals from the impressed account(s) even to a level below that of the outstanding indebtedness. Proposed *§ 701.39(c)(2)*.

C. Section 701.39(a)—What is a Statutory Lien?

1. Definition

The proposed rule defines a statutory lien under *§ 1757(11)* as a security interest in a member's shares and dividends equal to the amount of the member's indebtedness to the credit union. Proposed *§ 701.39(a)(1)*. The security interest established by the lien gives the credit union a superior claim over all other creditors when claims are asserted against the member's account(s). *Id.* at *§ 701.39(a)(2)*. See D. Bridewell, *Bridewell on Credit Unions* 710 (1942 ed.).

2. "Floating" Lien

The NCUA Board continues to believe that Congress intended for the statutory lien to be a "floating" lien. When a federal credit union impresses a lien on a member's accounts, it retains the lien on those accounts from that date forward through the term of the loan, to the extent of the unpaid loan balance together with interest, fees and other charges attributable to the loan. The lien "floats" as the outstanding balance of the indebtedness varies from time to time, and as the member's account balance is reduced by withdrawals or increased by deposits or dividend payments. When the statutory lien is enforced, it applies to all funds in the account at that point, the amount of which may well be less than the outstanding balance of the indebtedness.

3. Preemption

The proposed rule expressly provides that *§ 1757(11)* preempts state law. Proposed *§ 701.39(a)(3)*. This means that the proposed rule overrides the equitable right of set-off, as well as state statutory and decisional law governing a creditor's right to impress and enforce a lien. Many state laws require a

creditor to obtain a court judgment on the debt before enforcing a lien. The NCUA Board continues to maintain that federal credit unions should be free of this restraint, as are other federally-insured financial institutions. Accordingly, the proposed rule specifically provides, apart from general preemption, that a court judgment on the member's debt is not a prerequisite to enforcing a statutory lien. Proposed § 701.39(c)(3).

4. Member's Indebtedness

While § 1757(11) can be read to apply to member financial obligations beyond indebtedness to the credit union, the proposed rule reiterates NCUA policy limiting its application to a member's outstanding indebtedness and related charges. Proposed § 701.39(a)(4). For example, a statutory lien could be used to offset unpaid loan principal and interest and charges related to the loan, such as a late fee and collection expenses. But the statutory lien cannot be used to offset financial obligations outside the context of indebtedness to the credit union, such as a returned check charge, safe deposit box rental fee or overdraft on a withdrawal from an Automatic Teller Machine. It may be possible to offset such financial obligations under a federal credit union's statutory authority to receive payments on shares, 12 U.S.C. 1757(6), and to exercise incidental powers, 12 U.S.C. 1757(17), provided that the credit union has duly adopted a nonstandard by-law or board policy establishing its right to do so. See also 12 C.F.R. 701.35.

A member is indebted to the credit union if he or she is the maker or co-maker of a note or equivalent instrument establishing his, her or their personal indebtedness to the credit union. Whereas IRPS 82-5 was silent on guarantor liability, the proposed rule provides that a member who co-signs as a guarantor of the indebtedness of another member also is considered to be indebted to the credit union. Proposed § 701.39(a)(4). Thus, the credit union account(s) of the guarantor also may be impressed with a statutory lien. If the maker of the note or equivalent instrument then defaults, the credit union can enforce the statutory lien on the guarantor's account, thereby effecting the agreement to guarantee the maker's indebtedness to the credit union.

5. Exemptions

Certain forms of indebtedness to a credit union cannot be collected by means of a statutory lien. In the case of outstanding indebtedness due to extensions of credit under a credit card program, the Truth in Lending Act, 15

U.S.C. 1666h, and Regulation Z, 12 C.F.R. 226.12(d), both apply to generally prohibit a federal credit union from offsetting against a member's account that member's indebtedness arising from a consumer credit transaction under a credit card plan. In the case of a member's Individual Retirement Account ("IRA"), the Internal Revenue Code, 26 U.S.C. 408(a)(4), provides that the "interest of an individual in the balance of his account is nonforfeitable," thus barring a credit union, as trustee of the IRA, from impressing a statutory lien on an IRA. See *In re McDaniel*, 41 B.R. 132 (Bankr. W.D. Tex. 1984); *In re Dunn*, 5 B.R. 156 (Bankr. N.D. Tex. 1980). Finally, in the case of a member who is in bankruptcy, if the bankruptcy court issues an automatic "stay" of all creditor claims against the member, 11 U.S.C. 362(a)(7), the credit union is prohibited from enforcing its statutory lien on the member's account(s) while the stay is in effect.

6. Limitations

Apart from outright exemptions, credit unions should be aware that certain types of ownership interests in a credit union account will limit the extent to which a credit union can enforce a statutory lien under § 1757(11). For example, in the case of an account held as a tenancy in common between members, a statutory lien would be enforceable only against the debtor's 50% interest in the contents of the account (absent evidence of a disproportionate interest). No such limitation on enforcement generally exists with accounts held individually, or as a joint tenancy, or as a tenancy by the entirety between married members.

D. Section 701.39(b)—How is a Statutory Lien Impressed?

1. Impressing a Lien

A credit union may impress a statutory lien in either of three ways: (1) by noting the existence of the lien in the credit union's records of the member's account(s) and giving notice thereof to the member at the time the loan is granted, § 701.39(b)(1); (2) by reciting in a loan document signed by the member that shares and dividends are subject to the lien, § 701.39(b)(2); or (3) by duly adopting a by-law establishing a statutory lien to satisfy its members' delinquent indebtedness, and giving notice of the by-law to the member at the time the loan is granted, § 701.39(b)(3). See, e.g., *Federal Credit Union Bylaws*, Art. III, § 5(d) (12/87 ed.). See *Credit Manual for Federal Credit Unions* 16-17 (May 1972 ed.).

2. Notice

To ensure that members are aware when their credit union impresses a statutory lien on their accounts, proposed § 701.39(b)(1) and (2) require the credit union to give written notice to the member, contemporaneously with granting the loan, that the credit union is either noting the statutory lien on its records of the member's account(s), or is impressing the lien on those accounts through a duly adopted by-law authorizing the credit union to do so. The notice requirement applies whether the member is the borrower or is the guarantor of another member who is the borrower. Separate notice to the member is not required when a statutory lien is recited in a loan document signed by the member, § 701.39(b)(2), because the member is presumed to have read any document he or she signs, and thus to have become aware of the statutory lien.

E. Section 701.39(d)—How is a Statutory Lien Enforced?

1. Enforcement

Generally, a credit union may enforce its lien on the shares and dividends of the member by debiting the member's account and applying the funds to satisfy the outstanding indebtedness. Section 1757(11) preempts state law, meaning that a credit union is not required to follow state laws governing liens, nor to exercise the equitable right of set-off. In particular, this means that a credit union does not have to obtain a court judgment on the member's indebtedness before enforcing the lien, even if the state law requires a creditor to do so as a prerequisite to enforcement.

2. Statutory Lien Versus Share Secured Loan

A statutory lien differs from a loan secured by the member's pledge of his or her shares, commonly known as a "share secured loan." In the case of a share secured loan, the member is not allowed to withdraw shares to a level below the outstanding balance of the indebtedness at any time during the term of the loan, regardless whether the member is current on the loan. See NCUA, *Credit Manual for Federal Credit Unions* 28 (12/79 ed.). See, e.g., *Federal Credit Union Bylaws* Art. III, § 5(c) (12/87 ed.). In contrast, when a statutory lien has been impressed, a credit union may permit routine withdrawals from the member's account without waiving the statutory lien, even if the withdrawals would reduce the account balance to a level below that of the outstanding balance of the indebtedness. Only when the credit

union enforces the lien, following the member's default, can it then bar the member from making withdrawals. When enforced, the statutory lien applies to all funds then in the account(s); due to prior withdrawals, those funds may amount to less than the outstanding balance of the indebtedness.

F. Withdrawal of Current Interpretive Ruling and Policy Statement

Concurrent with adoption of the proposed rule regarding the statutory lien, the NCUA Board will withdraw the current IRPS 82-5 regarding the statutory lien, 47 FR 57483 (December 27, 1982).

G. Regulatory Procedures

1. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (primarily those under \$1 million in assets). The proposed rule on the statutory lien would reduce existing regulatory burdens. Therefore, the NCUA Board has determined and certifies that the proposed rule, if adopted, will not have a significant economic impact on a substantial number of small credit unions. Accordingly, a Regulatory Flexibility Analysis is not required.

2. Paperwork Reduction Act

The proposed rule has no information collection requirements. Therefore, no Paperwork Reduction Act analysis is required.

3. Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The proposed rule does not apply to State-chartered credit unions and, thus, would not effect State interests. Therefore, no analysis is required.

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Insurance, Liens, Mortgages, Reporting and recordkeeping requirements, Surety bonds, Statutory liens.

By the National Credit Union Administration Board on October 22, 1998.

Becky Baker,

Secretary of the Board.

For the reasons set forth in the preamble, it is proposed that 12 CFR chapter VII be amended as follows:

PART 701—ORGANIZATION AND OPERATION OF FEDERAL CREDIT UNIONS

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 *et seq.*, 42 U.S.C. 1861 and 42 U.S.C. 3601-3610. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. Part 701 is amended to add § 701.39 to read as follows:

§ 701.39 Statutory lien.

(a) *What is a statutory lien?* (1) *Definition.* A statutory lien is the power granted by section 107(11) of the Federal Credit Union Act (the Act), 12 U.S.C. 1757(11), to a federal credit union to impress (*i.e.*, to establish) a security interest in a member's shares and dividends equal to the amount of that member's indebtedness to the credit union, as that amount varies from time to time.

(2) *Superior claim.* A statutory lien gives the federal credit union priority over all other creditors when claims are asserted against the member's account(s).

(3) *Preemption.* A statutory lien pursuant to section 107(11) of the Act, 12 U.S.C. 1757(11), preempts state laws governing the right of a creditor to impress and enforce a lien, as well as the common law right of set-off.

(4) *Member's indebtedness.* A statutory lien may be applied to a member's account(s) only to satisfy a member's outstanding indebtedness to the credit union, such as loan principal and interest and other charges attributable to the indebtedness. For purposes of this section, a member is considered to be indebted to the credit union if he or she is the maker, co-maker or guarantor of a note or equivalent instrument establishing indebtedness to the credit union.

(5) *Exemptions.* To the extent provided by federal law—(i) A statutory lien may not be impressed on a member's Individual Retirement Account;

(ii) A statutory lien cannot be enforced to offset a member's indebtedness arising from a consumer credit transaction under a credit card plan;

(iii) A statutory lien cannot be enforced against the account of a member who is the subject of bankruptcy proceeding when a "stay" order of the bankruptcy court, issued pursuant to 11 U.S.C. 362, is in effect.

(b) *How is a statutory lien impressed?* A credit union can impress a statutory lien on a member's account(s)—

(1) *Account records.* By noting the existence of the lien on the credit union's records of the member's account(s) and providing written notice thereof to the member at the time the loan is granted; or

(2) *Loan documents.* In the case of a loan, by reciting in a loan document signed by the borrower that a statutory lien is impressed on his or her shares; or

(3) *By-Law.* Through a duly adopted credit union by-law or board policy establishing a statutory lien on member accounts, provided that written notice of such by-law or board policy is given to the borrower at the time the loan is granted.

(c) *How is a statutory lien enforced?*

(1) *Application of funds.* A federal credit union may enforce its statutory lien on a member's account by debiting the balance of funds in the account and applying it to offset the member's outstanding indebtedness, including unpaid loan principal and interest, and fees and charges attributable to the indebtedness.

(2) *Default required.* A federal credit union may enforce its statutory lien on a member's accounts only when the member is in default on his indebtedness to the credit union.

(3) *Judgment not required.* A federal credit union need not obtain a court judgment on the member's debt prior to enforcing its statutory lien on the member's account.

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 711

Management Official Interlocks

AGENCY: National Credit Union Administration.

ACTION: Notice of proposed rulemaking.

SUMMARY: The National Credit Union Administration (NCUA) proposes to revise its rule regarding management interlocks. The proposal conforms the interlocks rule to recent statutory changes, and was drafted through a coordinated effort among the following other federal financial regulatory agencies; the Comptroller of the Currency (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); and Office of Thrift Supervision