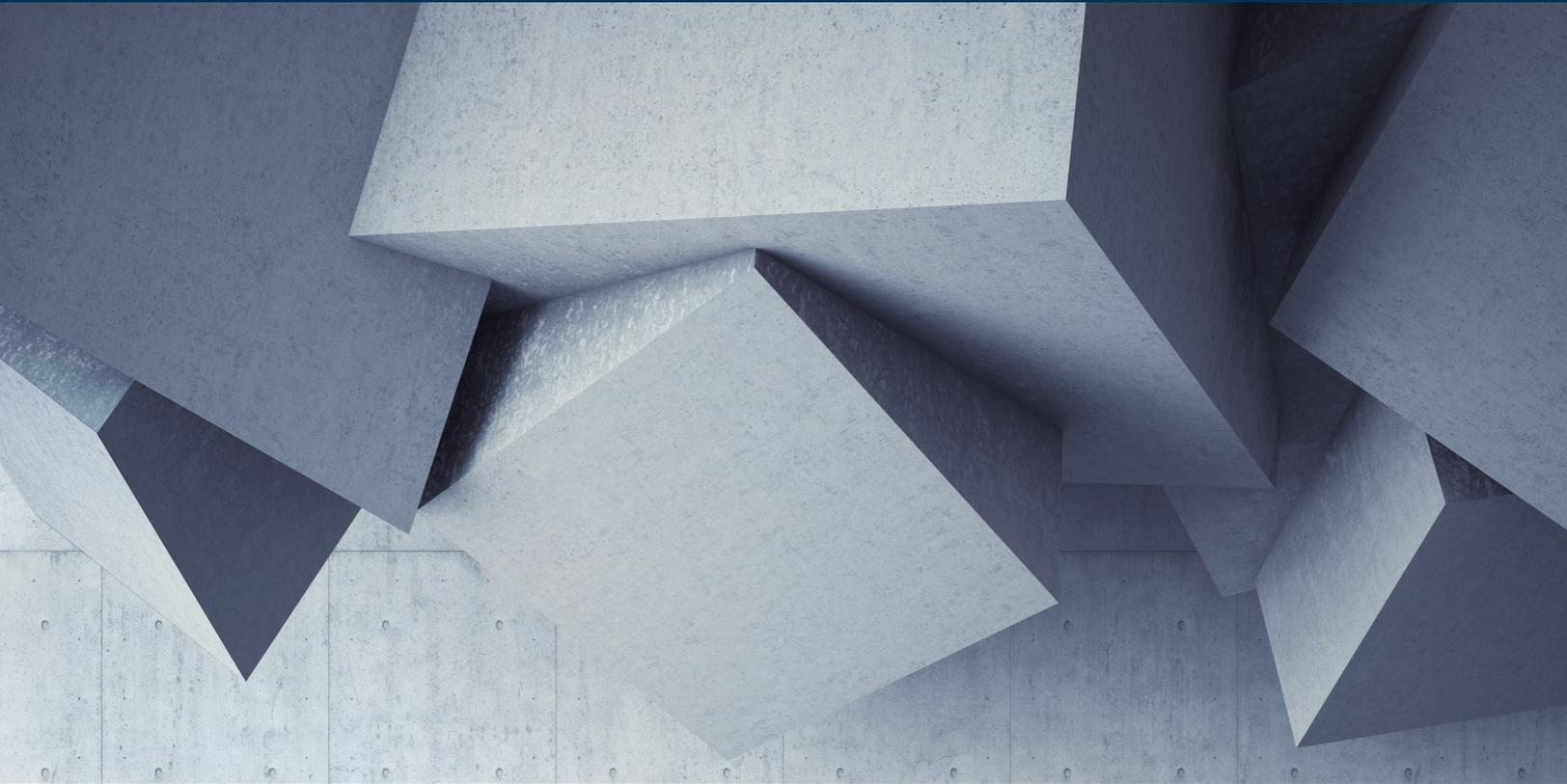

Model Law for Credit Unions

2015 EDITION



Developed and Recommended by
World Council of Credit Unions, Inc.



MODEL LAW FOR CREDIT UNIONS

2015 Edition

**Developed and Recommended
by World Council of Credit Unions, Inc.**

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WORLD COUNCIL OF CREDIT UNIONS

MISSION STATEMENT

World Council of Credit Unions (World Council) is the apex trade association and development organization of the international credit union system. It promotes the sustainable growth of credit unions and financial cooperatives across the globe. As instruments of economic and social development, 57,000 credit unions in 105 countries serve over 217 million people. In pursuit of our vision to improve people's lives through credit unions, World Council's mission is to be the world's leading advocate, platform, development agency and good governance model for credit unions.

PREFACE TO THE MODEL LAW FOR CREDIT UNIONS

Since the initial publication of this guide in the early 1990s, the majority of the world's credit union movements have modified their legislative framework and many new or revived movements are growing.

All over the world, experience has indicated that a country cannot maintain sustainable progress without a sound financial system. A critical element of a sound and stable financial system for developed and developing nations is the presence of a strong financial cooperative/credit union sector.

Creating enabling legislation and supervision is crucial to establishing sound financial cooperatives/credit unions. Often credit union expansion has come about slowly, based on existing laws which were not specifically designed for credit unions.

The most impressive and sustainable growth, however, has stemmed from laws written specifically for credit unions that strike an appropriate balance in terms of establishing safe and sound regulation without imposing unreasonable regulatory burdens.

This 2015 revision to the *Model Law for Credit Unions* is the result of more than two years of consultations with credit union stakeholders worldwide and adds a new Part XII to the Law entitled "Rule of Law, Transparency, and Administrative Procedure." These rule-of-law provisions are modeled primarily on the United States of America's Administrative Procedure Act and related U.S. Supreme Court precedents.

World Council believes that the revised *Model Law* will continue to prove to be a reliable and useful resource for those leaders throughout the world who seek progressive legislative change for credit unions and those responsible for enacting such change into law. It is available from World Council's website at www.woccu.org/publications.

World Council of Credit Unions, Inc.

September 2015

A USER'S GUIDE TO THE MODEL LAW

INTRODUCTION

Credit unions have been important contributors to economic and social development for over 150 years in all regions of the world. Credit unions are now significant participants in the national financial markets of many industrialized, developing and transitional economies. In many jurisdictions, however, legislation has not kept pace with the development of the credit union movement. Legislative and regulatory deficiencies, as well as excessive regulatory burdens, can imperil the safety and soundness of credit unions and restrict their ability to meet their members' financial service needs.

PURPOSE OF THE MODEL LAW

The purpose of this *Model Law for Credit Unions* is to aid movement leaders, legislators, regulators and others in preparing and seeking approval of laws that will strengthen the safety and soundness of credit unions without imposing unreasonable regulatory burdens. The *Model Law for Credit Unions* can be considered an optimal legislative framework for a jurisdiction that is revising its credit union regulatory regime or starting from scratch. Within this framework there is also recognition of locally accepted standards.

Democratic Participation

Democratic participation within a strong corporate governance framework is the foundation of successful, safe and sound credit unions. Shareholder participation helps to ensure accountability in the governance of the credit union. Elected officials and staff keep members informed about the services, performance and condition of the credit union by regular communications, transparent disclosure of its financial statements and key indicators. Members are assured of the accuracy of the financial disclosures by reports from external auditors, the internal audit performed by the Supervisory Committee and of the analysis and examination performed by the credit union's Superintendent or Supervisory Body.

All users of credit union services, including both savers and borrowers, should be members because at its fundamental level a credit union is a depository institution that is owned by its customers, who are its member-shareholders, on a cooperative basis. Some financial services such as money transmission and check cashing can be provided to non-members. However, incentives should be created so that all service users can easily purchase at least one ownership share in order to become full member-owners. This assures that all persons who use the credit union are given the right to become members and elect the voluntary officials who will oversee the sound management of their institution.

Specialization in Financial Services

Successful credit unions specialize in providing top-quality financial services. They concentrate their efforts on mobilizing their members' savings with competitively priced, convenient and easily withdrawable savings accounts, and on making loans to members at reasonable rates. Funds which are not on loan to members are placed in safe investments, where they are readily available to meet members' demands for savings withdrawals and/or loan disbursements.

Oversight and Governance

Elected officials and paid staff are responsible for a credit union's safety and soundness. Internal audits should be performed by the Audit Committee or the internal auditor on a periodic basis. A full annual audit shall be carried out by external auditors who report to the Audit Committee, as well as the annual general meeting of members. The law: (1) needs to require that all elected officials remove themselves from deliberations on actions that affect them personally; and (2) should require bond coverage on all staff and officials responsible for credit union funds or property. Having such bond coverage in place, if available, should be required on the date that a credit union can legally operate.

Savings and Credit Services

Credit unions should be clearly empowered to offer a variety of competitive savings and credit products that will meet the needs of their members. Most savings should be in the form of withdrawable deposit accounts. Ownership shares have

the primary role of establishing the members' ownership interest as the institution's equity-holders and can also serve as a form of institutional capital. Deposit products should be fully withdrawable, since they are considered to be liabilities and not risk capital.

The interest rates should cover all financial, operating, loss protection and reserve accumulation costs. Interest rates on loans, savings and the dividends should be set based on market conditions and business planning that ensures all operational and financial costs are covered; rates should not be established in the law or bylaws. Loans to officials, to non-natural persons and for higher-risk purposes such as business activities should be made at arm's length and closely monitored and controlled.

Asset Allocation

Ideally, credit unions should allocate the major portion of their members' savings to making loans to members, if sufficient loan demand exists, in order to serve their members' borrowing needs. Nevertheless, a reasonable percentage of the credit union's savings and other liabilities should be kept in liquid investments to meet members' withdrawal and loan demands. Excess liquidity can be invested in term deposits or debt securities with low levels of credit risk. A credit union's ability to pay out deposits and make loan disbursements without delay is, to most members, a key and immediate sign of its safety and soundness.

Regulatory Capital

A credit union's regulatory capital consists of institutional capital and secondary capital. Institutional capital consists of the capital reserves and accumulated surpluses (retained earnings) which it has generated as profits as well as, in many jurisdictions, ownership shares subject to covenants regarding permanency and/or preferred shares or another form of share which also have a high degree of permanence and ability to absorb losses on a going-concern basis. Secondary capital typically consists of subordinated debt and general provisions above and beyond what is needed for identified loan or investment losses. These funds belong to the membership as a whole, not to individual members, although the members' ownership shares represent equity and have claims on the credit union's residual assets in a liquidation.

Safe and sound credit union laws should establish a minimum level of regulatory capital to be considered "adequately capitalized" and a mechanism for earnings retention for institutions that do not meet the adequately capitalized level. In the *Model Law* it is recommended that undivided earnings be transferred to the reserves until it equals a prescribed percentage of assets. Including a "target" level of capitalization above the amount needed to be adequately capitalized can be useful, but should not result in "prompt corrective action" or similar supervisory restrictions if the credit union meets the requirement to be adequately capitalized. The credit union should establish and maintain a loan loss allowance which is separate from the reserves, and sufficient to cover all probable loan losses. Credit unions need to establish interest rates on their loans that cover the interest and dividend costs of their deposit savings accounts, operating expenses, loan losses and additions to their reserves to maintain capital adequacy.

Financial Stabilization

Financial stabilization mechanisms have been developed by some governments through the establishment of a Stabilization Fund and/or a Deposit Insurance System. In some jurisdictions they perform the role of the Supervisory Body, in others they exist in addition to the Supervisory Body. They can provide financial and technical assistance to credit unions in difficulty and thereby assist in preventing their failure. As such the role of a Stabilization Fund is to act to prevent a collapse. A *limited* scope Deposit Insurance System provides compensation to savers in the event of the collapse of their depository institution whereas a Deposit Insurance System with a *broader* scope and can also seek to prevent failures of credit unions and compensate savers upon failure of an institution. The *Model Law* addresses some of the basic issues of establishing a Stabilization Fund and Deposit Insurance System, but more detailed guidelines will need to be developed within each country.

Regulation and Supervision

Credit unions, like all financial institutions, depend on public confidence for their success. Members need to be assured that their savings in the credit union are as safe as or safer than they would be in any other financial institution. In addition, they want to receive financial services which are equal to or better in price and quality than those offered by the credit union's competitors. To achieve these two conditions in most countries, credit unions need to be supervised by a regulatory agency specializing in financial institutions and have direct access to elements of the financial infrastructure including central bank lending, credit bureaus, deposit insurance, clearing and settlement of payments, securitization

markets and card networks.

The *Model Law* recommends that credit unions be examined and supervised by a specialized organization responsible for regulating financial institutions. A regulatory structure should be capable of providing supervisory examination and enforcement which is appropriate for credit unions as specialized cooperative financial institutions. In some countries, regulation by non-financial and unspecialized agencies, such as cooperative ministries, has not provided adequate protection for members' savings.

Credit Union Associations

Credit union system viability can be greatly enhanced by the establishment of specialized associations of credit unions and central finance facilities. These organizations can provide unique educational, promotional, legal, financial, advocacy, insurance and commercial services tailored to the needs of credit unions. They can reduce costs for credit unions and/or increase their earnings, both of which are necessary to build institutional capital while offering competitively priced savings and loan products and services.

THE NEED FOR CREDIT UNION LEGISLATION

An ultimate objective of the credit union movement in any jurisdiction should be the enactment of a specific enabling law for credit unions. While credit unions are cooperative organizations, their specialization in financial services makes them different in many significant respects from other cooperative societies and credit only microfinance institutions.

General cooperative societies acts which govern the business operations of agricultural, consumer, commercial and industrial cooperatives are usually inadequate for credit unions, which are depository institutions whose business operations most closely resemble banking institutions. Microfinance institution legislation generally does not recognize the savings orientation of credit unions.

Legislation intended for commercial banks is generally inappropriate for the capital and cooperative governance structures of credit unions and often imposes unreasonable regulatory burdens on credit unions and other smaller financial institutions that do not engage in cross-border financial activities. In addition, credit unions' purpose as providers of cooperative financial services to members-owners who are its depositors and borrowers is also distinctive from commercial banks because few, if any, of a commercial bank's customers are its owners. Some of the key features which distinguish credit unions from other cooperatives, microfinance institutions and commercial banks include the following:

Democratic Control by Member-Owners

Unlike banks, credit unions do not have external shareholders. Instead a credit union's shareholders are the members who receive the financial services provided by the credit union. Each member is entitled to one vote in the democratic processes of the credit union, regardless of the amount of the member's individual share holdings. The governing body of the credit union is known as the board of directors. They are elected from the members by the members and voluntarily serve in a governance position to represent the best interests of the members.

Member Savings Mobilization

Unlike non-financial cooperatives and prototypical microfinance institutions, credit unions mobilize members' savings in the form of withdrawable deposits. To assure the members that these deposited funds are safe, credit unions require a specialized system of examination and regulation that is not needed by non-financial cooperatives or microcredit/credit-only programs.

Credit Union Capital

Credit union institutional or "risk" capital is made up principally of reserves and retained earnings accumulated from operations in addition to any paid-in ownership shares and/or preferred shares recognized as regulatory capital. Unlike commercial banks, a credit union's institutional capital is held by the credit union for the benefit of all but with a direct claim by none except for the members' ownership shares in a liquidation. Capital instruments including ownership shares, preferred shares, general provisions and subordinated debt may be utilized to expand the capital base of the credit union.

Return on Savings

Unlike non-financial cooperatives or some microfinance institutions, credit unions aim to pay competitive dividends and interest rates on ownership shares and deposit savings accounts.

Access to the Financial Infrastructure

Unlike non-financial cooperatives, credit unions generally need access to payment, clearing, credit bureaus, credit/debit card networks, deposit insurance and securitization markets typically accessible to financial institutions under the central bank regulation. Because of these differences, credit unions have been most successful where they operate under specific credit union legislation. This legislation assures that they will continue to operate according to cooperative and credit union principles while also providing sound business management and a careful system of internal and external controls.

PART I

PRELIMINARY

Part I deals with the identity of the Credit Union Act: its official name, its effective date and its application to other existing acts. The distinguishing characteristics of a credit union are also defined, as are other terms used throughout the Act.

1.10 Title of Act

Purpose:

To give the official title of the Credit Union Act, as well as a more concise reference term.

Contents:

1. Long Title: An Act to provide for the licensing, operation and supervision of cooperative savings and credit societies to be known as credit unions. This Act defines the powers, licensing, operation and supervision of credit unions.
2. Short Title: This Act may be cited as the Credit Union Act of [Year].

Commentary:

Customarily the long title is used to delineate the subject matter of the law and to distinguish it from other areas of the country's code of laws. The short title is a more concise reference term for citing in legal writings, in other documents and in the Act itself, and in some jurisdictions only what is referred to here as a "short title" is used as the only title of the Act. Local legislative usage should be observed.

Variants in the designation of a "credit union" are found in some countries; some prefer the more complete term "savings and credit union." Others substitute the word "cooperative" for "union."

1.15 Effective Date

Purpose:

To state the time when the Act becomes operative.

Content:

This Act takes effect in its entirety [or the sections indicated] upon enactment by the [appropriate legislative body] and approval by the [appropriate executive official, if required].

Commentary:

The enactment and approval procedure will depend on the enacting country's form of government. It is important, though, to indicate the date on which the law becomes operative and whether it is the entire law or parts of it that take effect on specified dates.

1.20 Repeal or Transitional Provisions

Purpose:

To repeal or amend any existing laws or regulations pertaining to credit unions under which they were formerly organized or registered.

Content:

(ALTERNATE A - Repealing an Existing Credit Union Act):

1. The Credit Union Act of [insert year] is repealed. All credit unions which prior to the effective date of this Act were registered under the Credit Union Act of [insert year] are deemed to be registered under this Act.

(ALTERNATE B - Repealing Credit Union Sections of a Cooperative or other Act):

1. The Cooperative Societies Act *[or other appropriate title]* of *[insert year]* is amended to the extent necessary to repeal all provisions relating to credit unions. All credit unions that were registered under the Cooperative Societies Act prior to the effective date of this Act are deemed to be registered under the Credit Union Act.
2. All regulations and bylaws issued or approved under the Cooperative Societies Act continue in force under this act, until such time as new regulations or bylaws are issued under this Act *[by a specified time]*.

Commentary:

The Alternate A repealer is applicable where a prior Credit Union Act exists.

Alternate B (or something similar) is applicable where credit unions are currently organized under another law, such as a General Cooperative or Friendly Societies Act.

To avoid disruption, it is important to make clear that all existing credit unions are now governed by the new Credit Union Act but that former regulations and bylaws remain in force until replaced by a date to be set in the Act.

1.25 Application to Other Acts

Purpose:

To define the application of other commercial and financial laws to credit unions.

Content:

1. Except as otherwise provided by this Act, the provisions of these codes of laws: *[list appropriate code titles]* are not applicable to credit unions.
2. The provisions of the Commercial Code *[or other appropriate code of laws]* are applicable to all business transactions of credit unions unless otherwise provided in this Act.

Commentary:

Depending on the system of law, it may be necessary to list those codes or specific laws which will govern the commercial transactions of the credit union and accord it full access to the legal system and courts. In some cases, though, this is not required where licensing or incorporation automatically makes such laws applicable. Conversely, it may be desirable to list specific laws from which credit unions are exempt, such as those dealing with other financial institutions.

1.30 “Credit Union” Defined

Purpose:

To define what constitutes a credit union, distinguishing it from other forms of cooperative enterprise and other financial institutions.

Content:

1. A credit union is a financial cooperative that may accept savings deposits, issue shares, and provide credit and other financial services to members.
2. A credit union is owned and controlled by its members. Natural-person individuals and legal entities may become members of the credit union if they meet the criteria for membership and subscribe to at least one ownership share. All members are shareholders and have one vote in the democratic proceedings of the credit union.
3. The objects of a credit union shall be:
 - a. to accept savings deposits from members;
 - b. to provide a source of credit for members at a fair rate of interest; and
 - c. to provide any other financial services that are useful and convenient for its members.

Commentary:

Credit unions are financial cooperatives. Through mobilizing members' savings deposits they create a source of funds to meet the credit needs of members. While credit unions exist primarily to serve their members, they may also provide some financial services to non-members in some jurisdictions. Non-members cannot save or borrow with a credit union, nor can they take part in democratic activities.

While credit unions are cooperative societies, they differ in many significant respects from other cooperative societies. Credit unions are depository institutions and their operations most closely resemble those of banking institutions. Some of the features which distinguish credit unions from other cooperatives and financial institutions are:

- 1. Their ability to accept deposits and provide credit is limited to their own membership.*
- 2. Unlike other cooperatives, they are able to accept fully withdrawable deposits from their members.*
- 3. In developing credit unions working funds are comprised mostly of member non-liquid shares; in mature credit unions working funds are mainly deposits. Throughout this Model, the use of deposits as a primary source of funds as opposed to member shares is encouraged.*
- 4. They make loans to members at fair rates of interest based on the ability of the borrower to repay.*
- 5. Unlike non-financial cooperatives, financial institutions have minimum capital requirements. Credit unions cannot issue capital instruments that provide ownership stakes to non-members.*
- 6. The board of directors of a credit union is elected by the membership, from the membership.*
- 7. They operate as not-for-profit institutions because they operate not for charity, not for profit, but for service to their members. There are no external shareholders to satisfy; instead, profits are returned to members in the form of enhanced services and lower rates and charges.*
- 8. Upon dissolution of the credit union, all remaining surplus of the organization after payments to depositors and creditors should be distributed to the members pro rata based on their holdings of ownership shares because the member-shareholders are the owners of the credit union.*

1.35 Interpretations and Definitions of Terms

Purpose:

To define certain terms used frequently in the Act or that are basic to its understanding.

Content:

1. In interpreting this Act, the following definitions, which are not intended to be exhaustive, shall apply unless such application would produce a result clearly inconsistent with the context of the Act's provision.
 - a. Secondary Capital is a sub-set of regulatory capital that is generally equivalent to the Basel III concept of "Tier 2" capital" and which includes subordinated debt and general provisions held for unidentifiable losses.
 - b. Association of credit unions, central finance facility or federation means an organization whose membership consists primarily of other credit unions and may include organizations owned by or composed of credit unions, corporations or associations, which primarily serve credit unions.
 - c. Credit union service organization means an organization owned by or primarily comprised of credit unions and whose purpose is to service, support or advance the development of credit unions.
 - d. Deposit account means a savings balance held by a credit union and owned by a member which constitutes a liability owed by the credit union to the account owner.
 - e. Deposit Insurance System means the organization responsible for providing stability to the financial system through the monitoring of depository institutions and the provision of compensation to depositors in the event of dissolution of their depository institution.

- f. Institutional Capital is a sub-set of regulatory capital and means disclosed non-distributable reserves that are created or increased by appropriations of retained earnings, capital donations or other surpluses of the credit union, as well as ownership shares and preferred shares that have sufficient permanence and the ability to absorb losses on a going-concern basis. Institutional capital instruments are generally equivalent to the Basel III concepts of “Common Equity Tier 1” capital and/or “Alternative Tier 1” capital depending on the terms and conditions of the instrument in question.
- g. Liquid Assets means assets that can immediately be converted to cash for clearing and settling payments, meeting loan disbursements, withdrawals or other immediate cash needs of an institution.
- h. Ownership Share means an amount held by a member and established by the credit union as the member’s ownership stake in the assets of the credit union. Ownership shares with sufficient permanence and the ability to absorb losses on a going-concern basis are generally equivalent to the Basel III concept of “Common Equity Tier 1” capital.
- i. Preferred Shares means a class of shares that may have a combination of features not possessed by ownership shares, including properties of both an equity and a debt instrument (such as a pre-set dividend rate), and which are generally equivalent to Basel III “Additional Tier 1” capital instruments if they have sufficient permanence and the ability to absorb losses on a going-concern basis.
- j. Prudential Standards means financial standards that focus on the financial solvency of the institution.
- k. Regulatory Capital means the broadest scope of credit unions capital that can be used to absorb losses and to grow the institution. Regulatory capital is comprised of two parts, institutional capital and secondary capital.
- l. Superintendent means the administrative head of the Department of Credit Unions in the Ministry of Finance [or other designated agency].
- m. Supervisory Body means the organization responsible under the Act for regulation and supervision of credit unions and second-tier organizations.

2. The Superintendent or Supervisory Body may interpret by means of a regulation any ambiguous term not defined in the Act.

Commentary:

The general definitions aid in the consistency of statutory interpretation. They also provide a convenient way to refer to certain concepts throughout the Act without excessive repetition of descriptive phrases.

Suggested here, by way of example, are a few recurring terms that could be defined in this section. Another approach would be to define terms in their relevant sections throughout the Act. Other laws simply list the terms that are to be defined later in the regulations of the government regulator. For additional terms referred to in the Model Law, see the Glossary found in Appendix 3.

The term jurisdiction used throughout the Model Law is not defined above. It is used only as a generic reference to cover any of the many kinds of political entities that might be enacting a credit union law. The enacting entity’s actual name or reference term (e.g., national government, province, state) should be included in the definitions.

The government regulator is called Superintendent or Supervisory Body in the Model Law. However, titles used to designate this government regulator vary from jurisdiction to jurisdiction. Among the many found are Director, Superintendent, Administrator, Commissioner, Inspector General, Registrar and Board Chairman. The agency itself may be known as the Credit Union Department, Administration, Authority, Registry or Bureau.

PART II

ORGANIZING A CREDIT UNION

Presented in this part are the organizational procedures and criteria to be met by a group wanting to register or incorporate as a credit union. This section also restricts the use of the term "credit union" or any other term used locally to describe a "credit union-type" cooperative and identifies the need for prudential standards. It also allows recognition of a credit union organized in another jurisdiction.

2.10 Organizational Procedure

Purpose:

To set forth the procedure to be followed in forming a new credit union and having it registered as a legal entity.

Content:

1. Any *[insert number]* or more residents of legal age who share a defined criteria of membership may organize a credit union.
2. The founding members must:
 - a. Execute an application for incorporation in a prescribed form; and
 - b. Approve bylaws consistent with the Act and regulations to govern the credit union.
3. The application must state the proposed credit union's name, the location of its principal place of business and the names and addresses of the founding members.
4. The founding members must select the required number of persons to serve on the board of directors, the Credit Committee (if there is one) and the Audit Committee. Those persons must sign a statement agreeing to join the credit union and to serve in the designated positions.
5. The founding members shall forward to the Superintendent or Supervisory Body the application for a license, together with the proposed bylaws, the agreements to serve and a business plan demonstrating the proposed credit union's ability to attain economic viability within a reasonable period of time.

Commentary:

These organizational procedures are intended exclusively for credit unions. They would supersede any procedures found elsewhere in the law dealing with other corporations, businesses or cooperatives.

Sometimes credit unions are unviable because too few members join the institution. Cooperative legislation often contains very low thresholds for the number of members needed to start a cooperative which is unsuitable for financial intermediation unless additional members join the credit union after its formation. World Council recommends the minimum number of members for a credit union should be at least 300 as an operational matter, although it is not necessarily easy to convince potential members to join a credit union that is not yet operating as a going concern.

Some jurisdictions, including the United States of America's Federal Credit Union Act, only require a small number of potential members—who are the credit union's "incorporators"—to form the credit union as a legal matter, with the expectation that more members will join the credit union once it begins operations. See Section 103 of the Federal Credit Union Act, 12 U.S.C. § 1753 ("Any seven or more natural persons who desire to form a Federal credit union shall each subscribe before some officer competent to administer oaths an organization certificate in duplicate . . ."); see also Section 109 of the Federal Credit Union Act, 12 U.S.C. § 1759 ("Federal credit union membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Board, as may be elected to membership and as such shall each, subscribe to at least one share of its stock and pay the initial installment thereon and a uniform entrance fee if required by the board of directors.")

Subsection 4 helps ensure the availability of qualified leadership for a newly formed credit union. Some credit unions have been organized but failed to become operational because of the inability to fill leadership positions.

The need to develop a business plan (Subsection 5) compels the founders to give substantial thought to the practical aspects of operating a successful credit union such as adequate capital, demand for services, skilled management and marketing techniques.

Unlike bank chartering, World Council does not recommend a minimum amount of absolute capital required to start a new credit union because it is impractical to expect a large number of potential credit union members to invest in ownership shares of a credit union that is not yet in operation; rather the focus of newly chartered credit unions should be on capital accumulation through earnings retention. World Council prefers to see a strong business plan showing viability. A World Council survey of 11 jurisdictions shows that 45% do not require any start up capital, and of those that do require initial capital, the median amount of capital is US\$5,300.

2.15 Criteria for Licensing

Purpose:

To detail the responsibilities of the government supervisor in acting upon an application for organizing a new credit union.

Content:

1. The Superintendent or Supervisory Body shall determine whether to issue a certificate of licensing after weighting the following factors:
 - a. Whether the application and bylaws conform to the requirements of the Act and regulations;
 - b. Whether the characteristics of the field of membership described in the application, the proposed bylaws and the business plan are favorable to the economic success of the proposed credit union;
 - c. Whether the qualifications of the persons who have agreed to serve on the board and committees provide assurance that the credit union's affairs will be properly administered;
 - d. Whether appropriate bonding and deposit insurance arrangements will have been established at the commencement of operations; and
 - e. Whether the public interests will be served by licensing the credit union.
2. If a license is issued, the Superintendent or Supervisory Body shall return a copy of it, together with the approved bylaws, to the founding members for preservation in the permanent records of the credit union.
3. If a certificate is denied, the Superintendent or Supervisory Body must notify the founding members and set forth the reasons for the denial in writing. An appeal of the denial pursuant to Section 12.35 may be entered within 30 calendar days after the credit union receives notice of the denial. Alternatively, the founding members may file a revised application with the Superintendent or Supervisory Body if the revised application addresses the reasons for the initial denial.
4. No loans may be granted, credit extended or deposit accepted by the proposed credit union until a license has been received. Its founding members may only carry out activities necessary to apply for a license.

Commentary:

Some credit union Acts contain provisions regarding minimum capital requirements to be met within a specified time. This does not mean that a credit union must have the minimum level before it can open the doors. The key is to have a plan to reach the capital adequacy ratio required by the Superintendent or Supervisory Body within a reasonable period of time, which could be as long as ten years in some cases, because capital accumulation is necessary for the credit union's long-term viability. The law should specify a minimum ownership share capital investment to be made by each member (see Section 6.05) and a process for accumulating institutional capital established by the Superintendent or Supervisory Body.

The Superintendent or Supervisory Body may decline to register a new credit union based on the commonly accepted grounds of unlikely economic success or lack of qualified leadership. An adverse decision by the Superintendent or Supervisory Body on the application for licensing is a final agency action that can be appealed pursuant to Section 12.35.

2.20 Organization Application and Bylaws

Purpose:

To authorize the Superintendent or Supervisory Body to prepare standard organization forms and bylaws for a credit union and to require the Superintendent's or Supervisory Body's approval of any subsequent amendments to those documents.

Content:

1. To facilitate the organization of credit unions, the Superintendent or Supervisory Body may prepare standard forms of application for licensing, agreements to serve as credit union officials and bylaws. These standard forms may be prepared by the Association of Credit Unions with the Superintendent's or Supervisory Body's approval.
2. The certificate of licensing and the bylaws may be amended as provided in the bylaws. Proposed amendments must be submitted to the Superintendent or Supervisory Body, who must act upon them within 60 calendar days.
3. Members have the right to obtain a copy of the bylaws at the expense of the credit union.

Commentary:

Model bylaws would serve as a guide in drafting a credit union's individual bylaws and would not have to be followed in all aspects. Variations, however, would have to conform to the Act and regulations and be acceptable to the Superintendent or Supervisory Body. Similar approval would be necessary for any change in a credit union's criteria for membership as set forth in the certificate of licensing.

2.25 Use of Name "Credit Union"

Purpose:

To give a credit union the exclusive right to use its registered name. Also, to prohibit the use of the words "credit union" by an entity other than a duly registered one.

Content:

1. Every credit union organized under the Act must include the words "credit union" in its official name. No credit union may adopt a name that is either identical to the name of any other credit union in the jurisdiction or so similar as to be misleading or cause confusion. In such cases, the Superintendent or Supervisory Body shall deny the license application.
2. Only a credit union registered under this Act or a credit union authorized to do business in this jurisdiction may use a name or title containing the words "credit union" or any abbreviation thereof, represent itself as a credit union, or conduct business as a credit union. However, a federation or confederation of credit unions or an organization whose membership or ownership consist primarily of credit unions or credit union organizations may use the words "credit union" in its official name.
3. Credit union officers and employees may adopt titles that include the words "credit union" such as "Credit Union Manager" without committing an offense.
4. Violations of this section constitute a crime punishable by fines and/or imprisonment which are set forth in Part XIV of this Act. The Superintendent or Supervisory Body may also petition the appropriate court to order a halt to any violation of this section.

Commentary:

Subsection 1 restricts the use of a credit union's name by another credit union. This is done to avoid confusion by the

members and to prevent misleading representations. Subsection 2 restricts the use of the words “credit union” to legally registered credit unions and to organizations serving credit unions, such as a federation or confederation. This restriction should be applied to any other name used locally to designate organizations having the attributes of credit unions – e.g., “savings and credit cooperatives” or “cooperative credit societies” (see Comment, Section 1.10).

2.30 Fiscal Year

Purpose:

To establish a common business year for all credit unions.

Content:

The fiscal year of each credit union registered under this Act ends on the last day of December [or other month used].

Commentary:

A uniform fiscal year is a customary business practice, considered essential for reporting and statistical purposes. However, in some countries, each credit union is allowed to set its own fiscal year with the approval of the Superintendent or Supervisory Body. In those countries, it is believed a staggered business year is advisable to facilitate audits and examinations after closing the books and before the annual meeting. The resulting dispersal of year-end closing aids in the scheduling and staffing of annual audits and inspections.

2.35 Prudential Standards

Purpose:

To establish the basis for prudential standards for credit unions.

Content:

1. All credit unions should adhere to prudential financial standards in their operations.
2. Through regulations the Superintendent should establish the prudential standards as indicated in section 11.15.

Commentary:

The establishment of and adherence to prudential financial standards are necessary for a credit union’s viability. These prudential financial standards should be promulgated through a public comment and notice procedure as set forth in Title XII of the Model Law.

2.40 Foreign Credit Unions

Purpose:

To recognize officially a credit union organized in another jurisdiction which has a valid reason to do business in the jurisdiction of the Act, and conversely, to allow a credit union organized under this Act to have operations in another jurisdiction.

Content:

1. A credit union organized under the laws of another jurisdiction may apply for a license to conduct business as a credit union in this jurisdiction by making a license application to the Superintendent or Supervisory Body. In determining whether to approve this license application, the Superintendent or Supervisory Body shall weigh the following factors:
 - a. Whether the credit union is organized under a law substantially similar to this Act;
 - b. Whether the credit union is in save and sound condition;
 - c. The credit union’s business purpose for wishing to operate in this jurisdiction;
 - d. The qualifications of the credit union’s board of directors, committees, and senior management;

- e. Whether appropriate bonding and deposit insurance arrangements will have been established at the commencement of operations in the jurisdictions; and
 - f. Whether the public interests will be served by licensing the credit union to operate in this jurisdiction.
2. A credit union organized under the laws of another jurisdiction that has received approval from the Superintendent or Supervisory Body pursuant to Subsection (1) of this Section is subject to the provisions of this Act and the regulations promulgated pursuant to this Act.
 3. A credit union organized under this Act may conduct business outside of this jurisdiction in other provinces or countries where it is legally permitted to conduct business as a credit union.
 4. The supervisor located in the jurisdiction where the credit union is incorporated shall coordinate responsibility of supervising with the host supervisor.
 5. The Superintendent or Supervisory Body may revoke the license of a credit union if it finds that the credit union does not meet the requirements of this Act, has engaged in unsound practices or is no longer authorized to operate in its home jurisdiction. The host supervisor shall have primary responsibility for the transactions related to all financial institutions operating in its borders.

Commentary:

Credit unions serving employees or members of multi-country organizations are often required to maintain facilities in places other than the one where the credit union is registered. This section enables a credit union organized in another province or country to serve its members in the jurisdiction enacting this law, if it receives the necessary license. A reciprocal provision by the non-local credit union's home province or country is desirable but not required.

Subsection 3 is a companion authority making clear that a local credit union may do business outside its own jurisdiction where permitted by the law in the other jurisdiction.

As electronic fund transfer and electronic transactions are introduced into a financial system, this issue becomes less and less relevant, as jurisdictional boundaries are more difficult to impose.

PART III

POWERS OF A CREDIT UNION

This part authorizes a licensed credit union to exercise the basic powers of any corporate entity such as the power to hold and dispose of property, enter into contracts, take part in legal proceedings, and exercise incidental powers.

3.10 General Powers

Purpose:

To declare that upon licensing a credit union may exercise generally accepted corporate powers.

Content:

Subject to the Act, licensing of a credit union under Part III of this Act renders it a body corporate with perpetual succession and, without limitation, the powers to:

1. Acquire, lease, hold, assign, pledge, mortgage, discount or dispose of property or assets;
2. Enter into contracts;
3. Institute and defend against lawsuits and other legal proceedings;
4. Mobilize deposits and borrow in an aggregate amount not to exceed a multiple of capital as prescribed in the prudential standard established by the Superintendent or Supervisory Body;
5. Accept deposits, provide loans and related financial services;
6. Exercise those incidental powers as may be useful or convenient to enable it to carry out effectively the purposes for which it is organized; and
7. Exercise the powers, rights and privileges of a natural person as necessary.

Commentary:

The question of general powers to be exercised by a corporate body such as a credit union can be approached in different ways. In some jurisdictions, an "express" law is obligatory under the legal system. All of the powers, services and organizational details must be expressly set forth in the statute, or they are not permissible.

In other countries, a legal entity may exercise any power, consistent with its purposes that is not expressly prohibited or limited by the statutes.

This Model Law suggests some standard powers enjoyed by companies or corporations in many jurisdictions. These powers are also deemed essential for credit unions to function effectively in a commercial environment and have all of their financial transactions held legally valid. Whether these powers must be detailed in the Act, as done here, will depend on which of the above legal philosophies prevails in the enacting jurisdiction.

Subsection 6 is another way to emphasize that a credit union may exercise incidental powers to accomplish its purposes under the law that may not be specifically enumerated in the Act. It should be read in conjunction with Section 1.25 – "Application to Other Acts."

3.15 Other Powers

Purpose:

To provide additional powers a credit union may exercise that are more specific to its purposes.

Content:

In addition to the powers enumerated elsewhere in the Act and regulations, a credit union may:

1. Purchase and assume assets and/or liabilities of another credit union;
2. Merge with another credit union or group of credit unions;
3. Hold membership, including investing in ownership shares, in a federation, confederation or similar institution, including a central credit union, central liquidity facility or a deposit insurance system;
4. Be a direct participant in payment and clearing systems, central bank liquidity lending, card networks, credit bureaus and/or securitization markets.
5. Serve as a fiscal agent for and receive payments on deposits from a governmental body;
6. Collect, receive and disburse monies in connection with the provision of negotiable checks, money orders, money transfers, foreign exchange, travelers checks and other money instruments and the provision of services through automated and mobile devices for the benefit or convenience of its members, and charge fees for such services;
7. Act as a trustee, accept and hold in trust real and personal property;
8. Act as trustee or custodian of any form of retirement, pension, profit sharing, severance or deferred income accounts authorized under the *[specified law]*. These may include pension funds of a company or organization whose employees are members or are eligible for membership in the credit union or retirement funds of self-employed individuals;
9. Invest funds in accordance with section 8.15 of this Act and the regulations;
10. Purchase or make available various forms of insurance for its members, either on an individual or group basis; and
11. Broker financial products such as securities and annuities.

Commentary:

Powers specific to the purposes of a credit union, such as those related to savings, authorized investments and loans and other member services, are found elsewhere in the Act. The powers cited here generally deal with relationships the credit union may establish with other entities.

Subsections 3 and 4 enables credit unions to establish and participate in a unified credit union financial system. Besides other credit unions, this system could include central credit unions, a federation or league of credit unions and various service or support organizations. Among the support groups could be a central finance facility for credit unions, an insurance society and a deposit insurance system to assist with solvency problems. See Part X - "Credit Union Associations."

Subsection 4 enables a credit union to have access to key components of a country's financial infrastructure. Together these components can make credit unions more competitive and resilient.

Subsection 5 allows a credit union to serve as a fiscal agent for various agencies of government, such as a town, village or school district, and to hold on deposit public revenues collected. A source of liquidity for the credit union, this can also be a valuable service to smaller government agencies, particularly in remote areas.

Automated teller and mobile banking and payments services are included in the list of permissible monetary services that a credit union may provide and charge a fee for under Subsection 6. This list is not intended to be exhaustive, but does reflect current forms of monetary services and instruments.

Subsection 7 would permit a credit union to accept, administer and execute trusts pursuant to a country's trust laws. Feasible only for large, well-staffed credit unions, it is suggested here only as an optional provision. However, it must be emphasized that a credit union serving as a trustee assumes a fiduciary responsibility that carries with it a high duty of care in the trust context that would not apply in the context of the credit union's provision of deposit accounts, payments services, or lending services. A trust involves a split of legal and equitable title to property, and countries with legal systems that are influenced by English common law typically define a "trust" in a manner similar to the following: "A fiduciary relationship regarding property and subjecting the person with title to the property to equitable duties to deal with it for

another's benefit” Black’s Law Dictionary 1513 (7th ed. 1999). Trustee powers should only be granted when appropriate regulatory safeguards are in place and a credit union has demonstrated the expertise to properly exercise them.

Having the credit union as a trustee or custodian of retirement or pension plans (Subsection 8) could be of considerable value to members who over the years work for a variety of employers. It would enable them to accumulate their pension contributions from various employers at one credit union. Deposits of company pension funds could also help build a credit union's pool of funds available for lending.

Subsection 10 would enable a credit union to offer life, broker casualty or health insurance, among others, to its members under either group or individual policies. Group insurance that might be provided could be related to the extension of credit or the receipt of savings, such as credit life or disability insurance, life savings or depositors life insurance. The furnishing of insurance services by a credit union would normally be subject to any insurance regulations of a country.

PART IV

MEMBERSHIP OF A CREDIT UNION

As cooperatives, credit unions accept deposits and provide credit only to their members. Some laws also require a credit union to define its membership criteria in its bylaws. This is widely known as a “common bond” or “field of membership.” In countries where this is a requirement, this part establishes who may become a member of a credit union. It also places ultimate control of the credit union with the members through the general meeting where policy direction is given to officers elected from the membership to govern on behalf of the members.

4.10 Membership

Purpose:

To indicate the kinds of groups or communities of interest that may become members of a credit union.

Content:

1. A credit union may accept deposits, provide credit and other financial services to its members. A natural person or legal entity must be a member in order to save or borrow from the credit union.
2. The bylaws of a credit union will prescribe the requirements for membership, including the criteria for membership, the number of shares to be subscribed and any membership fee to be paid.
3. To become a member of the credit union, a person must meet the membership criteria set forth in the bylaws. The membership criteria may consist of one or multiple common bond(s) of association or community of interest among the persons who belong to it. These common bonds may include, but need not be limited to, persons:
 - a. Who have a similar occupation or profession or are employed by a common employer or within the same business district or market area;
 - b. Who have common membership in an association or organization, including, but not limited to, religious, social, cooperative, labor or educational groups;
 - c. Who reside, work or worship within the same defined community or province.
4. A credit union may provide to non-members fee-based financial services that do not directly impact the assets or liability of the credit union. A credit union may not accept deposits or provide credit to non-members.

Commentary:

In registering or licensing a credit union to operate, the Superintendent or Supervisory Body is concerned that the credit union has a sound business plan and skills to manage it. Prudential concerns of safety and soundness should be the principal assessment made by the Superintendent in determining the scale and area of the credit union’s operations. An assessment of the criteria of membership and the extent of commonality between the potential members of the credit union should not be the sole focus of the Superintendent.

A traditional requirement for organizing a credit union under the laws of many countries has been a requirement for it to be formed by a group or groups having a community of interest or common bond of association, although some jurisdictions have eliminated the common bond requirement altogether. As ordinarily interpreted, this means the founding members of the credit union, and those subsequently joining, must be a part of some preexisting entity, or residents in the same community. The common bond was traditionally viewed as a form of credit enhancement, although it is questionable whether common bonds continue to act as a form of credit enhancement today. With the introduction of electronic transactions, funds transfer and shared branching, the issue of geographic proximity is becoming less relevant and can result in credit unions with very broad common bonds such as all persons who live or work in a particular province or state.

A credit union can only accept deposits and provide credit to members in most jurisdictions, although in some jurisdictions credit unions can accept non-member deposits and provide non-members with a limited set of financial services, primarily as a means of financial inclusion and community outreach that is intended to result in the non-members becoming members. The intent of this provision is to make access to financial services available to as many people as possible without sacrificing the cooperative governance structure.

4.15 Others Eligible for Membership

Purpose:

To specify other persons or groups that may be admitted to credit union membership.

Content:

1. Persons belonging to the immediate family of a credit union member may also be admitted to membership in the credit union, Section 4.10 notwithstanding. Immediate family includes the spouse, parents and children of a member, whether living in the same household or not, and any other individual living in the same household as the member.
2. Societies, associations, credit unions, partnerships, companies and governmental units that fall within the credit union's criteria for membership may be admitted as a member of the credit union.

Commentary:

It is often desirable to permit persons closely related by blood, marriage, civil unions, or adoption to enjoy credit union services in their own right. This is particularly true of children, who thus learn of credit union benefits at an early age. The holding of a joint savings account with an immediate family member may lead to the desire to have membership in the credit union. A joint account holder is not automatically a member.

This section will need to be reviewed in conjunction with national laws, many of which contain a definition of "family."

Under Subsection 2, persons other than natural persons may belong to a credit union.

The trend in many countries is to move the membership criteria from an associational or employment-based common bond to a community-based common bond in order to obtain growth of membership, and some jurisdictions have eliminated common bond requirements altogether. With the increased use of electronic processing methods, the cost of doing business has decreased; therefore, it is essential for credit unions to have an expanded scope of membership criteria in order to remain competitive with other financial institutions. This issue will also become more relevant as competitors embrace new technology. As a result, the service expectations of credit union members will increase.

4.20 Termination of Membership

Purpose:

The law shall require the bylaws to provide for conditions under which membership in the credit union is terminated and also to allow retention of credit union membership by persons who no longer meet the criteria for membership due to a change in circumstances.

Content:

1. The bylaws of a credit union shall specify the conditions under which a person's membership in the credit union shall cease voluntarily or involuntarily. The bylaws may permit a member to maintain their membership although their circumstances may have changed and they no longer meet the current membership criteria.
2. Any member may be expelled by a majority of the board with the member having the right to appeal to the board and, if required, to the next annual meeting.

Commentary:

This provision assures that retired employees and others who have withdrawn from the field of membership can continue to enjoy the privileges of credit union membership. The concept of "once a member, always a member" is traditional in

the credit union movements of many jurisdictions. Modern-day technology and shared branching arrangements make it even more feasible for a credit union to continue to serve members in remote locations.

Subsection 2 permits the members to expel a person from membership with appropriate safeguards for the member. Such action is sometimes necessary where a person has abused privileges of membership (repeated or excessive delinquency as defined in bylaws) or willfully attempted to harm the credit union.

Withdrawals of shares and deposits by a person ceasing to be a member would be subject to any notice, requirements or charges imposed by the credit union under Sections 6.05, 6.10, 6.15 and 6.25.

4.25 Liability of Members

Purpose:

To limit an individual member's liability for the corporate obligations of the credit union.

Content:

The members of a credit union are not personally or individually liable for the payment of the credit union's debts in excess of the amount of their individual ownership shares.

Commentary:

Credit unions almost universally have taken advantage of the principle of limited liability of shareholders for the debts of a corporation, a tenet of western corporate law. Experience has shown that it is very difficult to base a credit union movement on a system of unlimited liability.

4.30 General Meetings of Members

Purpose:

To provide for democratic control of a credit union through general meetings of the membership.

Content:

1. The annual general meeting of the members of the credit union will be held at the time and place and in the manner indicated in the bylaws, except that the meeting must be held no later than four months after the close of the fiscal year. The bylaws shall also provide for the calling of special meetings by the members, by the board of directors and by the Audit Committee. The bylaws shall specify the minimum number of members that must be present to conduct the business of any meeting of the members. A special general meeting of the members may be called by 30% of members signing such a petition.
2. At all such meetings a member will have but one vote, irrespective of how many shares owned. A member may vote by absentee ballot, mail or other electronic ballot method if the bylaws of the credit union so provide.
3. The minimum age a person must have attained as a qualification of eligibility to vote at meetings of the members, to hold office, or both, should be equal to the legal age of majority.
4. An organization having membership in the credit union may be represented and have its vote cast by a designated member or shareholder of the organization.
5. At the annual general meeting the members shall elect from among themselves natural persons to comprise of the board of directors and the Audit Committee.

Commentary:

The principle of one vote per member, regardless of the amount of share holdings, is a basic tenet of the cooperative movement and has been uniformly observed by primary-level credit unions. However, allowing absentee balloting by mail or holding separate meetings at different times and places in some credit unions, particularly the larger ones, may be desirable to assure maximum member participation in elections and policy decisions. It may also be the only practical means of obtaining the majority consent legally required on certain propositions.

The bylaws should address the matter of the quorum requirements of Subsection 1. In some places it is extremely costly or difficult to get a majority of the members to attend a meeting.

Election of the board of directors and the Audit Committee is reserved to the annual general meeting of the members, since both bodies are delegated to represent the members - the board in managing the credit union's business affairs and the Audit Committee in safeguarding the integrity of operations. The Credit Committee, on the other hand, is to be selected by the board of directors (Section 5.15), since it is responsible for implementing the loan policies of the board. Other committees, such as an Education Committee or Nominating Committee, may be named by the board of directors.

4.35 Regional Meetings of Members

Purpose:

To provide alternatives to the general meeting of members for credit unions with large and dispersed memberships, either by dividing the general meeting into area sections or by using a system of delegates elected at regional meetings.

Content:

1. The bylaws may provide for a credit union to hold a general meeting of the members by holding two or more regional meetings at different times and locations. The sectional meetings shall together constitute a single general meeting, and the total vote cast at the sectional meetings shall be counted after the last of the sectional meetings has been held to ascertain whether a resolution submitted to the members has been adopted or rejected.
2. The bylaws may provide for replacing the annual general meeting of the members with a system of regional meetings of the members at which delegates will be elected by the members to represent them at a general meeting. The number of delegates for each region will be determined in the bylaws.
3. A meeting of the delegates elected at the regional meetings shall be convened within *[specify number]* calendar days after the close of the regional members meetings.
4. The delegates meeting shall be responsible for conducting the business of the credit union normally reserved for the annual general meeting of the members. The delegates shall report to their respective regions on actions taken at the delegates meeting.
5. The bylaws may allow members to cast their votes by mail, in each branch or by electronic ballot which will then be counted at the annual meeting.

Commentary:

Credit unions with numerous or widely dispersed memberships or with remote branch offices may have difficulty holding a single general meeting of the members. Problems with finding convenient locations, adequate meeting facilities and acceptable timing are sometimes insurmountable. The three alternatives offered here have been used with some degree of success in certain countries.

Subsection 1 retains the general meeting of members, but divides it into two or more sectional meetings that can be held at different times and locations, if desired. The votes taken at the sectional meetings are then combined to ascertain the decisions made.

Subsection 2 substitutes a delegate system for direct member-wide meetings. Elected by the members at regional meetings, the delegates are convened at a general meeting at which only they may participate and vote. Actions taken by the delegates are binding on the entire membership and must be reported back to them.

Subsection 3 retains the general meeting of members and allows for the participation of a larger number of members by allowing in-branch voting. Detailed bylaw provisions and possibly general regulations would be needed to govern either meeting approach.

PART V

MANAGEMENT AND ADMINISTRATION

Under credit union law, the power to conduct the affairs of a credit union is delegated by the members to the board of directors upon the board's election at the Annual General Meeting. Part V establishes the authority and functions of this body, as well as of those persons appointed to administer the day-to-day operations of the credit union. Certain constraints are placed on those officials to better assure the integrity of the credit union.

5.10 Authority of the Board of Directors

Purpose:

To define the authority and responsibilities of the credit union's board of directors.

Content:

1. The board of directors is responsible to the members for directing and controlling the business, funds and records of the credit union. It reports annually to the members on its governance of the credit union.
2. The board consists of an odd number of directors, not less than five in number, elected by the members as provided in the bylaws. All directors hold office for fixed [*insert years*] terms, except terms are to be staggered so that an approximately equal number expires each year.
3. The board of directors meets regularly as specified in the bylaws. The bylaws shall specify the quorum required to conduct meetings of the board and of committees.
4. Directors must be in good standing. Any director having delinquent loans must resign from the board or bring his/her loans up to date. Any director who has failed to attend three consecutive board meetings may, at the discretion of the board of directors, be expelled from the board.
5. The officers, directors, and committee members owe a fiduciary duty to the credit union to operate the institution with reasonable prudence and in the best interests of the credit union and its members. The directors also owe the members a duty of fair dealing with respect to issues of membership, ownership, and corporate governance. In discharging these duties, directors may rely on reports, advice, and other information provided by the credit union's employees, lawyers, consultants, and committees of the board of which the director is not a member, unless the director has knowledge which would make such reliance unreasonable or in bad faith.

Commentary:

The annual meeting of members delegates to the board of directors the responsibility of managing the affairs of the credit union between annual meetings.

The optimal number of directors depends greatly on the size and complexity of a credit union's operations. However, experience shows some limits should be set on the size of a board of directors for effective decision-making.

Staggering the terms of directors assures continuity of leadership on the board. In some jurisdictions, the terms of directors are fixed at less than three years; or the number of terms a director may serve is limited, for example, to three or four consecutive terms. In those places it is felt the value of continuity of service is offset by the dangers inherent in entrenched leadership.

Term limits, if desired, should be prescribed in a credit union's bylaws. Whether term limits are desirable is a complex question which depends on a credit union's specific facts and circumstances since term limits can often conflict with the goal of having a well-qualified board of directors who can monitor and oversee the credit union's management in an effective manner. Some credit union systems have term limits for all credit union directors while, at the other extreme, director term limits are unlawful at federal credit unions in the United States of America because they are viewed as conflicting with members' right to elect directors of their own choosing.

5.15 Officers and Committees

Purpose:

To designate the executive officers and committees of the credit union.

Content:

1. At their organization meeting to be held within [*insert number*] days following each annual meeting, the directors shall elect from among themselves a chairperson, a vice chairperson, a treasurer and a secretary, who shall be the executive officers.
2. The terms of executive officers shall be one year or until their successors are chosen. Duties of the executive officers shall be set out in the bylaws.
3. The executive officers may be designated by the board of directors as an Executive Committee and be delegated authority to act collectively on behalf of the board of directors between board meetings, subject to any conditions or limitations prescribed by the board.
4. The board of directors shall establish a process for the election of an Audit Committee consisting of representatives from the membership.
5. The board of directors may appoint other officers or committees as necessary to effectively conduct the business of the credit union.

Commentary:

A unified system of officer titles is recommended. In keeping with the usage of many financial organizations, the board of directors could be headed by a chairperson, while the credit union's daily operations could be directed by a chief executive officer, whose title could conform to local usage (Section 5.30). Among the titles found are president, general manager, manager and administrator. Some localities still reserve the title of president for the elected head of the board of directors.

The designation of an Executive Committee would be at the option of the board of directors. The executive officers would act if there were a need to expedite decisions on essential activities between board meetings. The board would continue to be the chief policymaker acting on behalf of the members.

The board of directors shall establish the process for the election of an Audit Committee. Its members serve as volunteers and shall be elected from the membership. The Audit Committee performs an important governance function. Its primary responsibilities are:

- a. *To oversee the credit union's internal control systems; and*
- b. *To monitor the Board of Directors' compliance with law, regulations, bylaws and policies.*

As a credit union develops and introduces more sophisticated management processes, the traditional volunteer Audit Committee concept can be enhanced by employing a professional auditor to carry out an internal audit. The role of the Audit Committee is in addition to that of a professional external auditor. (In this version of the Model Law the term "Supervisory Committee" has been eliminated and replaced with the term "Audit Committee".)

As credit unions develop and start to use more sophisticated lending methods, the Credit Committee is made up of qualified lending staff. As the loan volume grows and more sophisticated lending assessments are adopted, it becomes necessary to employ professional management and qualified lending staff. The administration of the lending function is delegated to qualified staff such as Loan Officers within defined limits established by the board in the loan policy. (Special approval procedures for loans to officers, directors and employees of the credit union are found in Section 7.35.)

5.20 External Audit

Purpose:

To require an external audit of a credit union by a professional accountant.

Content:

1. At each annual meeting, the Audit Committee shall appoint auditors for the credit union from a list of approved auditors prepared by the Superintendent or Supervisory Body.
2. The Audit Committee shall have the accounts of the credit union audited within 90 calendar days of the close of each fiscal year by a professional accountant who meets the standards prescribed by regulation of the Superintendent or Supervisory Body. An audited financial report should be filed with the Superintendent or Supervisory Body.
3. The audit shall be conducted in accordance with professional auditing standards. At a minimum it should include a verification of cash balances, securities, member's accounts, a review of internal controls and an examination of delinquent loans and loans to officials. The auditor shall have access to all books, accounts, receipts and other documents of the credit union. Officers, directors and committee members must furnish the auditor with any information required relative to the transactions and operations of the credit union.
4. The auditor must report the findings on matters set forth in Subsection 3 and any recommendations to the Audit Committee in a management letter.
5. A person who is not independent of the credit union or of the directors of the credit union is disqualified from being an auditor of the credit union. A person is deemed not to be independent if that person or his or her business partner:
 - a. Is a spouse, business partner, director, officer or employee of the credit union; or
 - b. Is indebted to the credit union at the time the audit is performed.
6. An auditor who becomes disqualified shall resign after becoming aware of the disqualification.
7. The Audit Committee may, at a special meeting, remove from office and replace any auditor appointed by them.
8. The auditor shall report to the manager, the Audit Committee and directors in writing any transactions or conditions affecting the well-being of the credit union that, in the auditor's opinion, are not satisfactory and require recertification, and the auditor shall, as required, make a report to the Audit Committee on:
 - a. Any transactions that in the opinion of the auditor have not been within the powers of the credit union; and
 - b. Any unsound financial practices, transactions or policies that in the auditor's opinion may contribute to losses by the credit union.

Commentary:

An external audit provides an objective verification by a professional accountant of the accuracy of the financial records and accounts of the credit union. The standards for the accountant, to be set by regulation, should assure that the auditor has no conflicts of interest with the credit union.

No matter how conscientious, a volunteer Audit Committee seldom has the accounting skills to evaluate the credit union's operations as thoroughly and objectively as a professional auditor. The audit report is an essential tool for the board of directors, the members and the government supervisor.

Some jurisdictions, however, permit credit unions below a specified asset threshold to have their annual audits performed by the Audit Committee, instead of by an external auditor, in order to limit regulatory burdens on smaller financial institutions. See, e.g., Section 202(a)(6)(D) of the Federal Credit Union Act, 12 U.S.C. § 1782(a)(6)(D) ("Each insured credit union having total assets of \$500,000,000 or more shall have an annual independent audit of the financial statements of the credit union, performed in accordance with generally accepted auditing standards by an independent certified public accountant or public accountant licensed by the appropriate State or jurisdiction to perform those services.")

The audit's timeliness is critical. It should be undertaken within three months of the end of the fiscal year and the results reported to the annual general meeting of members.

5.25 Vacancies in Offices

Purpose:

To provide for interim filling of vacant offices in between annual meetings.

Content:

1. The board of directors shall fill any vacancies occurring in the board or Audit Committee until successors are elected at the next annual general meeting.

Commentary:

Because of quorum requirements, it is necessary to provide for filling vacant offices.

5.30 Chief Executive Officer and Employees

Purpose:

To authorize the appointment of a chief executive officer and other employees to administer the credit union.

Content:

1. The board of directors shall appoint a chief executive officer to whom it delegates the authority and responsibility for managing the credit union's operations. The board may authorize the chief executive officer to employ any additional persons needed to administer the business of the credit union.

Commentary:

A manager and other employees are necessary as the credit union's operations grow and become more complex. The board hires and sets the compensation of the chief executive officer, who is accountable to the board for the conduct of day-to-day operations. He or she, in turn, is delegated authority to hire, supervise and fix the compensation of any additional qualified employees needed. The board exercises general control over compensation through its approval of the operating budget. The chief executive officer serves as an ex-officio board member.

5.35 Conflicts of Interest

Purpose:

To prohibit officials from using their credit union positions for personal advantage, and to discourage nepotism.

Content:

1. No officer, director, committee member, agent or employee of the credit union shall in any manner participate in the deliberation upon or the determination of any question affecting that person's pecuniary interest or the pecuniary interest of any member of the immediate family of that person or of any company or organization (other than the credit union) in which that person is directly or indirectly interested. Such person must also disclose any conflict of interest to the board of directors and/or the Superintendent or Supervisory Body.
2. Violations of this section shall be subject to the penalties provided in Section 14.20.

Commentary:

It is an ethical norm for officers and directors to abstain from participation within the credit union on any business matter that affects their personal or family financial interest. This provision makes it a matter of law.

Officials who have other business interests thus avoid the temptation to subordinate credit union interests to their own financial advantage. The goal must always be to assure that any credit union transaction involving directors or officers is completed under normal, and not preferred, conditions.

5.40 Compensation

Purpose:

To ensure any compensation and/or reimbursement for the services of elected credit union officers, directors and committee members is made transparent.

Content:

1. Any elected officer, director or committee member may be compensated for services to the credit union.
2. All compensation and/or reimbursement from the credit union should be reported on an individual basis in the annual report.

Commentary:

It is essential that the credit union have competitive compensation packages for management, staff and directors so as to attract and retain competent, qualified individuals.

5.45 Insurance of Officials

Purpose:

To require the credit union to obtain fidelity bond coverage on officials responsible for funds or property of the credit union and to permit purchase of insurance to protect officials from liability incurred in their official capacities.

Content:

1. The board of directors shall purchase adequate fidelity bond coverage for the chief executive officer and for other officers, committee members, employees or agents handling or having custody of credit union funds or property.
2. A credit union may purchase insurance on behalf of a director, officer, employee or agent of the credit union against any liability incurred by such person arising out of his or her official capacity, provided such person acted honestly and in good faith with a view to the best interests of the credit union.

Commentary:

The Superintendent or Supervisory Body should set minimum requirements for coverage to be included in a blanket fidelity bond. The board of each credit union should have discretion to select any bond commercially available from any company that meets those minimum requirements.

Officers and directors are legally required to exercise a high degree of care and prudence in carrying out their official duties. Shareholder lawsuits alleging negligence can be lodged against them. The purchase of liability insurance to protect officers and directors from the potential financial burden of such suits may be necessary to attract qualified persons to hold office.

PART VI

SHARES AND DEPOSITS

There are two types of financial interests for members in the credit union – shares and deposits. Ownership shares represent a member’s equity ownership in the credit union, and preferred shares form a class of shares similar to preferred stock issued by a joint-stock company which have characteristics of both equity and debt. Deposits are the product used for member savings. The Model Law emphasizes the importance of savings primarily through fully withdrawable deposits as opposed to the traditional method of saving through subscriptions for shares.

6.05 Ownership Shares

Purpose:

To provide the basic form of ownership interest in the credit union.

Content:

1. A credit union may offer an unlimited number of ownership shares at a par value established in the bylaws.
2. The bylaws shall fix the minimum number of shares to which a member must subscribe and may provide for installment payments on such shares. The bylaws may also limit the number of ownership shares that may be held by any one member, but such limits must apply equally to all members.
3. The bylaws shall identify the redemption conditions of shares. Ownership shares cannot be redeemed above par value. Ownership share redemptions are subject to any notice requirements imposed by this Act, regulations, the bylaws, and/or the shares’ terms and conditions.
4. A member’s ownership shares cannot be used as security for a loan, but can be charged against if he or she has a debt outstanding to the credit union.

Commentary:

An organization may raise funds either by issuing ownership securities or by borrowing money. Traditionally, credit unions have been allowed by law to use both methods: 1) they issue ownership shares to members; and 2) they accept deposits from members and borrow from other sources.

A person desiring to deposit money and borrow from the credit union must first become a member, subscribing to and purchasing a minimum amount of ownership shares, as set in the bylaws (Section 6.10).

The ownership share is universally considered the basic form of ownership in the credit union, establishing membership rights and an interest in the credit union’s assets.

In a credit union that grants character loans on the basis of a multiple of deposits held, ownership shares would be excluded from the calculation.

6.10 Characterization of Ownership Shares

Purpose:

To define how ownership shares are characterized on a credit union’s balance sheet.

Content:

1. Ownership shares represent legal equity but are not considered part of the credit union’s institutional capital unless the conditions of Subsection 2 of this Section are met.
2. Ownership shares may only be considered institutional capital of the credit union if one of the following three conditions are met:
 - a. Shares are permanent, non-withdrawable, paid-in, available to absorb losses on a going concern basis, have no

fixed maturity, and may only be redeemed upon membership termination and then, only if the credit union can meet its capital adequacy requirements established under section 9.20;

- b. A level of share capital has been fixed under which capital must not fall as a result of redemption of shares. The part of the shares above this “fixed” amount may be considered to be part of regulatory capital of the credit union;
- c. Shares are permanent, non-withdrawable, paid-in, available to absorb losses on a going concern basis, have no fixed maturity, and may only be redeemed out of proceeds of newly issued shares subscribed to by other members.

Commentary:

Saving through subscription for shares is discouraged in favor of fully withdrawable savings deposits, although shares can and often do form an important part of the credit union’s institutional capital.

Permanent non-redeemable ownership shares are at risk if the credit union’s losses exceed its retained earnings. The claims of members for their ownership shares are subordinate to the claims of depositors and other creditors.

6.15 Preferred Shares

Content:

1. A credit union may offer one or more class of Preferred Shares at a par value(s) established in the bylaws.
2. Preferred shares are shares that do not meet the requirements of ownership shares but have terms and conditions that give them a high degree of permanence and the ability to absorb losses on a going-concern basis, as defined by the Superintendent or Supervisory Authority by regulation.
3. Preferred shares cannot be redeemed above par value. Preferred share redemptions are subject to any notice requirements imposed by this Act, regulations, the bylaws, and/or the shares’ terms and conditions.
4. Preferred shares may include a pre-set dividend so long as the pre-set dividend is only payable out of earnings for the current fiscal year *[or at another periodic interval]*, and does not pay out unless the credit union has sufficient earnings during that time period to pay the dividend.
5. A member’s ownership shares cannot be used as security for a loan, but can be charged against if he or she has a debt outstanding to the credit union.

Commentary:

Preferred shares provide credit unions with the ability to raise capital from their members in addition to ownership shares. While less permanent than ownership shares, credit union preferred shares are also at risk of loss and should still provide a high degree of permanence and ability to absorb losses on a going-concern basis in a generally consistent with Basel III “Additional Tier 1 Capital” instruments whether or not the institution is subject to Basel III. Dividends should only be paid only if there are available earnings from the fiscal year operations, although preferred shares typically have a dividend preference over ownership shares.

6.20 Dividends

Purpose:

To provide for a monetary return to members on their ownership shares based on available earnings.

Content:

1. At the close of a fiscal year *[or at another periodic interval]*, the board of directors may declare dividends to be paid on ownership shares from available earnings if the credit union has sufficient regulatory capital and has made sufficient provisions for loan losses. Dividends may be authorized only after making the required reserve transfers.
2. Dividends may be paid at various rates, taking into consideration the conditions pertaining to each type of share account.

3. The Superintendent of Supervisory Body reserves the right to exempt a credit union from section 1 above as it deems appropriate.

Commentary:

Dividends should only be paid after reserve transfers are made, and only if there are available earnings from the fiscal year operations. It is essential that the rate of return to members be higher than the rate of inflation and competitive with the financial market.

6.25 Deposits

Purpose:

To establish the deposits as the major source of funds in the credit union.

Content:

1. A credit union may receive savings deposits from members in demand or fixed-term accounts. The terms, rates and conditions of deposits may be established by the board of directors.
2. Deposits have a prior claim on assets and have a pre-agreed interest rate and term.
3. A credit union must disclose the terms and rates it offers on its deposits in accordance with the regulations.

Commentary:

Deposits are the principal form of funds in the credit union, withdrawable on demand or according to a pre-agreed term. The common forms of deposits include: a) term deposits maturing on a fixed date; b) demand deposits payable to third parties as in checking accounts; and c) regular savings accounts with no maturity date.

Although Subsection 1 allows for deposits from governmental units and other sources, the focus of the credit union should be on mobilizing member deposits. Subsection 2 indicates that deposits are in effect a debt or liability of the credit union. They are owed to the depositors and must be repaid prior to any final liquidation of the remaining assets of the credit union.

6.30 Interest on Deposits

Purpose:

To provide for a periodic interest return to members on their deposits.

Content:

1. At periodic intervals the rate of interest to be paid on deposit accounts is determined, taking into consideration any minimum balance, notice and term requirements, as well as prevailing market rates of interest and the credit union's ability to pay.

Commentary:

This section permits setting and paying of variable rates of return on deposits, according to the conditions or classes established. The rate of return on a deposit might be predetermined at the time the deposit was made, taking into account contractual conditions. The frequency of payment is not specified. A credit union could compound interest on deposits according to local custom - annually, semi-annually, quarterly or even daily, if desired.

6.35 Deposit Withdrawals

Purpose:

To provide conditions under which withdrawals of deposits may be made.

Content:

1. Deposits may be withdrawn for payment to members according to the terms and conditions under which the ac

counts were contracted and classified. Deposits may be withdrawn for payment to third parties as provided in the bylaws and the policies of the credit union.

2. Withdrawals of deposits are subject to any advance notice requirements contained in the terms of the agreement of the account.

Commentary:

This section provides authority for third-party payments or transaction accounts, such as checking accounts.

6.40 Joint Accounts

Purpose:

To provide for joint ownership of credit union accounts.

Content:

1. A member may designate any person or persons to own a deposit account jointly with the member. On the death of one of the joint owners, the surviving owner or owners become the remaining owner or owners and member of the credit union.
2. Payment of part or all of such joint accounts to any one of the joint owners shall, up to the amount of the payment, discharge the credit union's liability to all of the owners, unless the account agreement contains a prohibition or limit on such payment.

Commentary:

This provision permits deposit accounts in the credit union to belong legally to two or more persons. It also allows such accounts, for example, to require the signature of all co-owners before a withdrawal can be made. Other local laws on co-ownership of property would have to be reviewed to assure this section's conformity.

6.45 Trust Accounts

Purpose:

To provide for accounts in a credit union held in trust by the credit union for the benefit of another person.

Content:

1. A deposit account may be owned by the credit union in trust for a beneficiary.
2. Beneficiaries may be minors, but no beneficiary shall be permitted to vote, obtain loans, hold office, or be required to pay membership fees unless he/she is a member in his/her own right.
3. Payment of part or all of such a trust account to the party under whose name the account is held shall, to the extent of such payment, discharge the liability of the credit union to that party and to the beneficiary. The credit union is under no obligation to see to the application of such payment.
4. If the credit union has been given no written notice of the existence or terms of any trust and has not received a court order as to the disposition of the account, the funds in the account and any dividends or interests thereon shall be paid to the estate of the member that established the trust upon his/her death.

Commentary:

This is an optional provision. It is recognized that some legal traditions do not permit the trust concept. For those that do, this is an explicit grant of authority for a credit union to offer deposit accounts owned by a member in trust for a beneficiary, who may or may not be a member, or owned by a non-member in trust for a beneficiary who is a member. The types of trusts that could be offered would be determined by the jurisdiction's law. Section 3.15 contains additional authority for the credit union to act as a trustee and additional commentary on trust law.

6.50 Charge Against Shares and Deposits

Purpose:

To allow a credit union to collect debts owed to it by drawing upon any account or other funds the debtor may have in the credit union.

Content:

1. A credit union has a lien and first charge against any dividends due, shares, deposits or interest payable to the member, for any debt due to the credit union by the member, either as a maker or co-maker on a loan or for any other obligation.
2. A credit union may offset any sum credited or payable to a member that is in arrears.
3. A credit union may refuse to allow withdrawals from any share or deposit account when an account-holder is in arrears on a debt to the credit union.
4. At a credit union's discretion, it may charge against a member's holdings as defined in 6.50.1, 6.50.2 and 6.50.3, while allowing the minimum amount of ownership shares required for membership to remain.

Commentary:

This section provides a charge against dividends, interest, ownership shares, or deposits, in order to make collections on debts owed to it by a member. This is a matter that may be covered by the loan instrument. Such a charge must conform to any other law dealing with property liens and right of seizure.

6.55 Dormant Accounts

Purpose:

To provide a means for the credit union to dispose of accounts inactive for extended periods of time.

Content:

1. If there has been no activity on a member's share or deposit account for [insert one or more] years, the board of directors may impose a reasonable maintenance fee on it. The credit union must give notice of this action to the member or known interested parties at the last known address, allowing at least 90 calendar days for a reply. Any such maintenance fee may be fixed at a rate that covers administrative costs. The credit union must maintain a separate accounting record of all such accounts.
2. Share and deposit accounts, dividends, interest and other sums due to a member or other person and held by the credit union may be presumed abandoned unless the owner has contacted the credit union in person or in writing within a period prescribed by regulation, or has otherwise indicated an interest in the funds.
3. The board of directors may credit the abandoned funds to a special reserve fund of the credit union; thereafter, no dividends or interest will accrue to the abandoned accounts and membership of the credit union may be forfeited. The credit union must send a notice of the intended action to the member or other person to whom the property is owed at the last address shown on the records of the credit union and must allow 90 days for response.
4. The member or other person may reclaim the abandoned funds by proper judicial or extra-judicial proceeding begun within [insert years] after the credit union credited the funds to the special reserve fund.

Commentary:

Some credit unions find it administratively burdensome to deal with a volume of inactive or abandoned accounts representing relatively small sums. This section allows imposing a maintenance fee on such accounts or transferring them to a reserve fund, where they no longer need be dealt with on an individual basis unless the owner reappears. Following identification of a dormant account, completion of contact action and removal of the account to a reserve fund, membership of the credit union is forfeited. These procedures must conform to local consumer financial protection laws.

PART VII

LOANS

A major purpose of a credit union is to make loans to members. The law generally imposes limits on loan terms and conditions to assure that loans are of maximum benefit to the borrower and that the credit union's interests are protected. These issues are addressed in Part VII.

7.10 Purpose and Conditions

Purpose:

To provide a general statement on the purpose and conditions for which credit union loans may be granted.

Content:

1. A credit union may lend money to members under conditions provided by the Act, regulations as well as by the bylaws and policies established by the board of directors.
2. The board of directors shall establish written policies in compliance with the Act, regulations and bylaws regarding the granting of loans, including the terms, conditions of repayment, maximum amounts that may be borrowed and acceptable forms of security. The chief executive officer is responsible for ensuring credit is granted in accordance with written policies.

Commentary:

Each credit union should be able to fashion its lending program according to the specific needs of its membership and its financial capacity. This provision permits the board of directors to devise lending policies that will take into account a variety of factors, such as the credit union's capital, liquidity and local economic conditions, as well as the needs, character and financial capabilities of the membership. Such policies, of course, must conform to the law and regulations.

7.15 Loan Limits and Security

Purpose:

To provide guidelines on acceptable forms of security and to place an overall restriction on loans to any one member.

Content:

1. Loans may be either secured or unsecured. In addition to generally accepted forms of security, endorsement of a note by a co-maker or guarantor, assignment of an interest in real or personal property or assignment of shares, deposits or wages may be deemed security.
2. The maximum amount that any member may borrow in the aggregate may not exceed *[insert number]* percent of the credit union's total capital to be set from time to time by regulation.
3. Subsection 2 notwithstanding, the maximum amount that the credit union may lend to its staff and officials in aggregate may not exceed a determined percentage of the credit union's total capital to be set by regulation.
4. Subsection 2 notwithstanding, a society, association, partnership or company admitted to membership under Section 4.15, should pledge as security property held by them in their organizational capacities or some other form of acceptable security.

Commentary:

The level of security required will depend on the type of lending used.

In the case of character lending, based on a member's deposit holdings, the amount of the loan in excess of deposits is unsecured. As such, the entire loan is unsecured, as it is not possible for a loan to be partly secured. If a guarantor is required for the part of the loan in excess of deposits then this would be a secured loan.

A determination as to the adequacy of security is best left to the judgment of the official or committee charged with loan approval. However, it must meet policy guidelines. A wide range of permissible forms of security is desirable. The credit union should ensure that the security offered is of sufficient value and will retain sufficient value to repay the loan. The credit union should also ensure that it takes appropriate steps to enable it to legally claim the security in case of loan default. The forms suggested here must be reviewed for conformity with the country's commercial law dealing with assignments of property or future wages. It should be noted that Section 6.50 gives the credit union an automatic lien on shares and right of set-off against deposits for any sums due it by a member.

The loan concentration policies established by the board governing the maximum sum that may be loaned to any one member shall be subject to the percentage-of-credit union capital limitation set in regulations. Limits on large exposures are usually expressed as a percentage of the credit union's total assets or its capital. The aim is to prevent excessive risk being concentrated with a single borrower. World Council recommends these loan concentration limits be set at the lesser of 10% of assets or 25% of regulatory capital. The board may establish greater limitations in its written policies based, for example, on the security value or a percentage of capital.

Subsection 3 places restrictions on the total amount of lending to staff and officials in an effort to insure against excessive "insider" lending. Some countries have established a level of ten percent of net capital as the limit on lending primarily to officials. If this provision is included, regulations should establish the appropriate level.

Subsection 4 places restrictions on loans. Business lending requires specialized expertise, scrutiny and should require security.

Business loans clearly fulfill one of the aims of a credit union, but they also pose considerable risk, particularly if a substantial portion of the credit union's assets are concentrated in a few business loans. The making of business loans demands specialized skills on the part of credit union management and should be carefully monitored by the credit union's board and Supervisory Committee, as well as the Superintendent or Supervisory Body.

7.20 Interest and Other Charges

Purpose:

To authorize setting of the credit union's interest rates subject to any general statutory or regulatory limits.

Content:

1. The interest rates on loans shall be determined subject to the limitations established in the [cite: usury law, Commercial Code or other appropriate statute] and the regulation on lending disclosure and fair credit practices.
2. In addition to interest charged on loans, a credit union may charge members reasonable expenses in connection with the making, closing, disbursing, extending, collecting or renewing of loans. A credit union may also assess charges to members, in accordance with the bylaws, for failure to repay loans in the agreed-upon manner.
3. The board of directors may authorize any refund of interest on such classes of loans and under such conditions as it prescribes.

Commentary:

The credit union loan interest rate is determined subject only to ceilings that may be set either by the Commercial Code or a general usury statute. Financial and strategic implications should be taken into consideration when interest rates are set. A deregulated rate system is preferable to a statutory one. In an inflationary economy market conditions may require timely increases in yields on loans, so that the credit union can pay rates that will assure the income needed to cover the risks of providing credit.

A credit union should also be able to pass on to borrowers certain charges incidental to making a loan, such as legal costs and government filing fees. It is often economically unsound for a credit union to absorb these charges on certain loans such as real estate. Subsection 2 also permits a credit union to assess fines or penalties for loan delinquency or other failures to meet obligations in a timely manner.

This provision offers flexibility as to the period for which an interest refund is to be paid and permits selectivity with respect to the kinds of loans on which it is paid. For example, crop loans which may have been made at reduced rates or loans which

may have been delinquent could be excluded from the interest refund.

7.25 Loan Application Procedure

Purpose:

To require written documentation of every loan.

Content:

A loan must be applied for in writing or permissible electronic means by filling out an application form. Each loan shall be evidenced by an appropriate legal document, such as a loan agreement or promissory note.

Commentary:

Proper documentation is essential in the event the credit union must later enforce payment through legal procedure. A loan application and loan agreement carefully drawn up by the Association of Credit Unions or other organization will facilitate evaluating the appropriateness of a loan. The application form format will have to match the type of lending, i.e., character or ability to repay.

The loan agreement shall comply with national laws on disclosures, transparency, truth-in-lending and consumer information.

7.30 Other Loan Programs

Purpose:

To allow other forms of credit union lending.

Content:

1. Upon written application by a member, a credit union may approve a line of credit or revolving credit. Loan advances may then be granted to the member within the limit of the line of credit. When a line of credit has been approved, no additional credit application is required as long as the aggregate indebtedness does not exceed the approved limit. Lines of credit shall be subject to periodic review.
2. A credit union may participate in loans to credit union members jointly with other credit unions, credit union associations or other organizations in accordance with the written policies of the board of directors. A credit union that originates such a loan shall retain an interest in the loan.
3. A credit union may participate with its members in any guaranteed loan program of the government under the terms and conditions specified in the law providing for such a program.
4. A credit union may purchase the installment sales agreements, leasing, loan contracts and similar loan instruments of its members.
5. A credit union may sell repossessed assets to a member or non-member and may finance such a purchase for any member.
6. A credit union may provide approval of loans in any format that sufficiently captures the information needed for a loan agreement.

Commentary:

This section doesn't attempt to include every possible type of credit union lending but rather establishes principles of a framework in which credit unions assess the risks, possess the expertise to judge the type of credit granted to members.

Subsection 1 authorizes an open-end or line-of-credit plan in a credit union. This is any system of lending which permits a series of credit extensions or add-ons to loans. The borrower does not need to request individual loans, but applies instead to use the open-end plan on a self-replenishing basis. Rather than receiving an initial sum on loan, approval gives the member the privilege of borrowing money from time to time when it is needed, as long as the member does not exceed the approved maximum.

Subsection 2 authorizes a credit union to pool its financial resources with those of another credit union, an association of credit unions or another financial organization to make loans to members. A participation loan greatly enhances the ability of smaller credit unions to meet the major lending needs of members, such as for the purchase of real estate.

Subsection 3 permits a credit union to participate in any government-guaranteed loan program under the terms and conditions of the law establishing the programs. Some countries provide special loan guarantee programs for educational, agricultural, small-business or housing purposes.

Subsection 4 facilitates a credit union's consolidation of a member's loans by allowing it to purchase prior loans made with other lenders.

Subsection 5 authorizes a credit union to finance the sale of repossessed property for any person, whether or not that person is a member. The financing of such property may be necessary to accomplish its timely disposal and the avoidance of loss to the credit union.

Subsection 6 enables a credit union to use technology to facilitate the loans process. This is subject to the loan policy of the credit union. Sufficient controls must be in place to prevent fraud and identity theft.

7.35 Loans to Credit Union Officials

Purpose:

To prevent conflicts of interest by placing special approval requirements on loans to officials of the credit union.

Content:

1. A credit union may make loans to its directors, employees and their immediate family members and related parties provided that:
 - a. the loan complies with all requirements under this Act, regulations and internal loan policies with respect to loans to members and is not on terms more or less favorable than those extended to other members with similar credit histories and capacities to repay;
 - b. the loan applicant may not be present nor participate in the consideration of the credit application and the requirements of Section 5.35, "Conflicts of Interest," must be met;
 - c. the credit union should develop and the board should adopt a policy on loans to officials including directors, employees, immediate family members and related parties subject to part 1.a. above. Any loan or aggregate loan(s) must meet the requirement of the loans to officials policy; and
 - d. loans to officials of the credit union shall be reported to and reviewed by the auditor, the Audit Committee and the full board.
2. A credit union may not permit directors, employees and members of its committees to act as co-makers, guarantors or endorsers of loans to other members.

Commentary:

Under this provision, the borrowing and endorsement privileges of credit union officials and their immediate family members (within one degree of separation) must correspond to those of other members. However, a safeguard is added, namely that a loans to officials policy should be established and adopted by the Board, that such loans are required to be reported to the auditor, Audit Committee and full board to ensure compliance, in addition to meeting all other loan requirements. Similarly, the requirements for loan approvals would be specified by the credit union's loan policy and must ensure that disinterested parties are involved in the approval process. The annual external audit is also required to give special attention to such loans (Section 5.20).

Some jurisdictions adopt an even more stringent approach of prohibiting all borrowing or endorsing by officials at the credit union they serve. In such instances, a special mechanism for credit union officers is organized through a single credit union or the central finance facility to meet the loan needs of credit union officials. Whichever approach is taken, it should be recognized that insider dealings pose a genuine risk to a credit union. Strict measures must be provided in the statute to guard against this risk.

PART VIII

INVESTMENT OF FUNDS

Although the main purpose of a credit union is to make loans to members, the law must give a credit union the power to invest for income the accumulated funds that are not used for loans to members. This part of the Model Law authorizes broad categories of investments, subject to limits. In addition, a portion of credit union funds must be kept in semi-liquid form to meet day-to-day cash demands. This part defines where deposits may be kept.

8.10 Board Responsibility

Purpose:

To place primary responsibility for establishing a policy on investing and deposit making with the board of directors.

Content:

1. The board of directors shall establish written policies for investing funds of the credit union not used in loans to members, and shall ensure that they are in compliance with legislative requirements. The chief executive officer ensures investments are made in accordance with the written policies.
2. The board of directors shall designate institutions to serve as depositories for credit union funds, in accordance with the regulations.

Commentary:

The board is responsible for selecting the institutions or organizations where credit union funds that are not invested in the loan portfolio should be deposited on a short-term basis for purposes of safekeeping. The regulatory agency may want to provide a list of sound financial institutions or a central finance facility, which it considers acceptable for receiving credit union deposits. This should not replace the due diligence that a credit union should perform on any potential depository institution.

Longer-term investments are to be made by the chief executive officer under written policies framed by the board of directors. This would permit the chief executive officer to delegate this function to an investment officer, but the chief executive officer would remain responsible for it to the board.

8.15 Authorized Investments

Purpose:

To provide a broad list of permissible investments of a conservative and substantially secure nature.

Content:

Subject to the act and the regulations, credit union funds not used for loans to members, may be invested in:

1. Securities, obligations or other debt instruments issued or guaranteed by the national government or any agency or political subdivision of the government.
2. Deposits, obligations or other accounts of regulated banking institutions organized under national law.
3. Loans to, shares or deposits of any central credit union, central finance facility, federation or any deposit guarantee corporation for credit unions. Any such organization so invested in must be registered under this Act.
4. Shares, stocks, deposits in, loans to or other obligations of any registered cooperative society, organization, company or association providing services associated with the general purposes of credit unions or engaging in activities related to the operations of a credit union. Such investments in the aggregate are not to exceed [*insert number*] percent of the credit union's capital and deposits.
5. Other investment-type securities or obligations as may be authorized under regulations.

Commentary:

This section permits a diversified range of substantially sound and conservative investment instruments for a credit union. Credit union investments of a speculative nature, such as common stocks, are discouraged by the virtue of their omission as an authorized investment. This is necessary if a credit union is to effectively manage its short-term and long-term liquidity needs and maintain an income flow adequate to pay a competitive return on savings. In some jurisdictions, credit unions are relieved of the responsibility for investments by requiring that funds be invested in a central finance facility. In this situation, the legislation would specify investment rules for the central finance facility.

Subsection 1 includes investment in securities, obligations or other instruments of the national government, its agencies or political subdivisions. If a country has a federal system, similar authority may be needed for state or provincial obligations.

Subsection 2 covers varied forms of deposits and investment accounts offered by banking institutions.

Subsection 3 permits a credit union to participate in a central finance facility and any stabilization program established to assist with liquidity and solvency needs of credit unions. A credit union, however, may not invest in another credit union (other than a central credit union) to prevent the introduction of systemic risk in related credit unions.

Subsection 4 provides a means for credit unions collectively to finance service organizations furnishing essential services such as data processing, liquidity management and group purchasing. Such investments are usually limited to 15 percent of capital.

The rules for investing statutory liquidity (i.e., the minimum legislated requirement) may be more stringent than those for excess liquidity (i.e., any excess over statutory). There could be a requirement for statutory liquidity to be invested in a central finance facility.

8.20 Liquid Funds

Purpose:

To require a credit union to maintain a portion of its assets in liquid form.

Content:

1. A credit union shall maintain a liquid funds target equal of at least [*percent*] of its aggregate savings deposits in liquid assets or demand deposit type of accounts to provide sufficient liquidity for share and savings withdrawals, external borrowing repayment, loan demand and operating expenses. This target percentage may be increased or decreased by regulation. Credit unions may use these reserves as a source of liquidity in the ordinary course of business but should in general remain close to this target percentage.
2. Such liquid funds must be maintained in the form of cash on hand; one year or less deposits with banking institutions, an association of credit unions, a central credit union, a central finance facility; or investments in readily marketable government obligations.
3. Credit unions should establish lines of credit with the central bank and/or other financial institutions as an additional source of liquidity.

Commentary:

Having a specific target amount of its assets in the form of cash or in an investment readily convertible to cash is important to a credit union's operation and to maintain members' confidence in the liquidity of the credit union. Such liquid funds enable it to meet day-to-day demands by depositors for withdrawal of their funds, to pay operating expenses of the credit union and clear payments.

These liquidity reserve targets are characterized as target amounts because these funds would not be available to meet the credit union's liquidity needs if the credit union were required to maintain a strict minimum level of "liquidity." In other words, establishing a minimum level of "liquidity" reserves that a credit union cannot use in its operations makes those funds illiquid.

PART IX

RESERVES AND ALLOWANCES

Credit unions are required to establish reserves and allowances, created out of earnings, to provide financial stability by maintaining a capital level to cover possible losses from loans, investments and other contingencies. This section provides a uniform approach to reserve allocations and usage.

9.10 Definition of Capital

Purpose:

To define the components of a credit union's capital account.

Content:

A credit union's regulatory capital is comprised of two parts: 1) institutional capital and 2) secondary capital:

1. The institutional capital may include:
 - a. The disclosed non-distributable reserves that are created or increased by appropriations of retained earnings, capital donations, ownership shares as defined by section 6.05 of the Act, or other surpluses of the credit union; and
 - b. Preferred shares as defined by section 6.15 of the Act.
2. Secondary capital may comprise no more than 50% of the total regulatory capital of the credit union and includes:
 - a. Subordinated debt as defined in section 9.15 of the Act.
 - b. General provisions which are held for presently unidentifiable losses.

Commentary:

Institutional capital is available primarily to absorb losses and to allow growth of the credit union. The accumulation of an adequate level of capital is essential in order to protect members' savings. Credit unions' business plans should strive foremost to capitalize the institution while also aiming to give members a real return on deposits and ownership shares.

Other terms besides capital that are used to describe the general reserve are regular, statutory or capital reserve. Besides the general reserve, a credit union may want to establish additional reserves designated for special purposes. Institutional capital also includes ownership shares and preferred shares that are sufficiently permanent and able to absorb losses on a going concern basis so as to be generally equivalent to "Common Equity Tier 1" or "Additional Tier 1" capital under Basel standards, whether or not the institution is subject to Basel III.

Secondary capital is modeled on the requirements for Basel III "Tier 2" capital, whether or not the institution is subject to Basel III.

9.15 Subordinated Debt

Purpose:

To define the conditions and parameters of subordinated debt for credit unions.

Content:

The following conditions will apply to subordinated debt:

1. The maturity of the instrument must be more than five years from the date on which the loan is made; during the last five years to maturity a cumulative discount factor of 20 percent per year should be applied;
2. The debt ranks ahead of all subordinated unsecured creditors including the credit union's shareholders;

3. The remedies available to the subordinated creditor in the event of default in respect of the subordinated debt are limited to petitioning for the winding up of the credit union or proving for and claiming in the liquidation of the credit union after payment of all priority obligations;
4. To ensure the cooperative nature of credit unions, debt holders shall not have voting rights;
5. The terms of the subordinated debt must be set out in a written agreement that contains terms providing the above conditions.
6. Clear written disclosures must be provided to the subscribers of the debt regarding the potential for loss and that the debt is not covered by deposit insurance.

Commentary:

Allowing credit unions to include subordinated debt as part of their capital may provide added safety during times of extraordinary growth. It is particularly useful for a new credit union or a credit union wishing to provide a new service for members.

9.20 Capital Adequacy

Purpose:

To define the minimum amount of capital account that should be held relative to the assets of a credit union.

Content:

Subject to the Act and regulations, the board will establish a policy recognizing:

1. The leverage ratio is calculated by dividing the regulatory capital of the credit union by its total assets without regard to risk-weighting of assets.
2. The Supervisor shall establish by regulation a generally applicable leverage ratio for credit unions to be considered “adequately capitalized,” as well as measures for prompt corrective action applicable to credit unions below the minimum ratio to be “adequately capitalized.” The Supervisor’s prompt corrective action regime must be designed to allow undercapitalized credit unions a reasonable period of time to build capital sufficient to become “adequately capitalized.” A target leverage ratio for a credit union to be considered “well capitalized” may also be established.
3. The Supervisor shall also establish by regulation one or more alternative minimum leverage ratio(s) and alternative prompt corrective action regime(s) for newly established credit unions and small credit unions below *[specify specific asset threshold here]* in total assets that are less stringent than the generally applicable capital adequacy ratio and prompt corrective action rules. The Supervisor’s alternative prompt corrective action regime(s) for new and small credit unions must be designed to allow these credit unions a reasonable period of time to build a level of capital that is sufficient to meet the generally applicable minimum capital adequacy ratio.

Commentary:

Most credit union systems do not apply Basel-based risk-based capital rules and have capital regimes that rely primarily on a leverage ratio of capital-to-assets without risk-related discounts of asset values. Although the risk weighting of the capital to assets ratio has become a requirement for credit unions in some jurisdictions, such as Australia and Canadian provinces—following the recommendation of the Bank for International Settlements’ Basel Committee on Banking Supervision for large, internationally active commercial banks—in general, risk-based capital regimes have limited usefulness for credit unions unless the credit unions in question have complex positions of assets and liabilities that are similar to the complex assets and liabilities of large, internationally active banks.

This section contemplates the Supervisor establishing a leverage ratio and prompt corrective action regime based on the leverage ratio requirement that is similar to the leverage ratio requirement and associated prompt corrective action rules established by the US National Credit Union Administration (NCUA) for federally insured credit unions under Part 702 of Title 12 of the Code of Federal Regulations, 12 C.F.R. part 702 (“Capital Adequacy”) (2015).

The Part 702 rules establish a leverage ratio of 6 percent capital-to-assets for a federally insured credit union to be considered “adequately capitalized” and set forth “prompt corrective action” requirements for credit unions that have lower

levels of capital, such as the requirement for the credit union to file a “net worth restoration plan” with the supervisory agency (which is usually a type of retained earnings accumulation plan, although a capital restoration plan involving the issuance of new capital shares to members would also result in a higher leverage ratio numerator) that makes realistic projections regarding how to accumulate sufficient capital to meet the “adequately capitalized” level within a reasonable period of time. See 12 C.F.R. § 702.206; see also 12 C.F.R. §§ 702.102, 702.201-702.206 (2015).

A “reasonable period of time” in this context could be up to ten years, see, for example, 12 C.F.R. § 702.301 (“A ‘new’ credit union for purposes of this subpart is a federally-insured credit union that both has been in operation for less than ten (10) years and has total assets of not more than \$10 million. A credit union which exceeds \$10 million in total assets may become ‘new’ if its total assets subsequently decline below \$10 million while it is still in operation for less than 10 years.”), or could be much less time, depending on the circumstances.

9.25 Allowance for Loan Losses

Purpose:

To require establishment of an allowance for possible losses on delinquent loans.

Content:

1. In accordance with guidelines prescribed by regulation, a credit union shall maintain a loan loss allowance for loans that are delinquent for periods in excess of 30 calendar days. The loan loss allowance shall be calculated in accordance with the generally applicable accounting standards in force in the jurisdiction where the credit union is located.

Commentary:

The loan loss allowance requires a credit union to transparently provision and account for delinquent loans. Funds are set aside from operating income to cover projected losses. In addition to an allowance for specific accounts, a non-specific allowance for unidentified risk can also be established. Loan loss allowances should be calculated according to the accounting principles that apply to the credit union as set by this Act or other applicable law, such as International Financial Reporting Standards or national generally accepted accounting principles.

In some situations, such as with respect to small or newly chartered credit unions, less-stringent regulatory accounting principles may be better scaled to the credit union’s level of development than would be International Financial Reporting Standards or national generally accepted accounting principles. We do not foresee a set of circumstances, however, where regulatory accounting principles that are more stringent than the jurisdiction’s generally applicable accounting rules would be appropriate for credit unions. To the contrary, regulatory accounting principles for credit unions that are more stringent than the jurisdiction’s generally accepted accounting rules would place credit unions at a competitive disadvantage relative to other financial institutions, would tend to artificially understate the credit unions’ true capital position; and—as a result—would likely reduce the stability of the credit union system compared to application of the jurisdiction’s generally applicable accounting rules.

9.30 Loan Write-Offs

Purpose:

To require all delinquent loans to be written off according to the applicable accounting standard, with all loans in arrears over one year to be written off the loan portfolio if the applicable accounting standard did not require those items to be written-off sooner.

Content:

1. If a balance on a delinquent loan is outstanding, this balance should be written off when either of the following two conditions occur:
 - a. The applicable accounting standard requires the loan to be written off; or
 - b. 365 days have elapsed since the last payment was made.

Commentary:

It is essential that management makes every effort to collect delinquent loans and that they recognize losses on loans delinquent which the jurisdiction's generally applicable accounting standard require to be written off so that financial statements portray the true financial position of the credit union. As a backup, any loans which are delinquent for 365 days or more should be written off even if the applicable accounting standard does not require it per se. Although a loan has been written off as an expense, collections should continue and money collected at a later date can still be taken into income as recoveries. All charged off loans should be recorded in a separate journal of "memorandum accounts" which are used to monitor accumulated charge-offs and recoveries.

PART X

CREDIT UNION ASSOCIATIONS

In order to develop fully and provide optimal services to members, credit unions require an effective secondary support system. Normally, this includes a central credit union, a league or an association of credit unions to provide an array of programs, services and systems to assist individual credit unions. It also includes either an in-house or a separate central finance facility to manage the liquid funds of member credit unions through inter-lending and investing. Part X deals with the purposes and services of such central organizations.

10.10 Association of Credit Unions

Purpose:

To provide for a central association or second-tier organization of credit unions.

Content:

1. A central association or league of credit unions may be organized by any *[specify number]* or more registered credit unions and/or financial cooperatives for the purpose of fostering the organization and development of credit unions and improving their operations. Such an organization shall register with the Superintendent or Supervisory Body but shall not be subject to the Act or regulations unless its engaged in financial intermediation or the settlement of payments.
2. Any credit union registered under the Act or authorized to do business in the jurisdiction may, at its discretion, become a member of the central, league or association.
3. A central, league or association shall be directed by a board of directors elected by member credit unions at the annual meeting. The bylaws shall prescribe the duties of the officers and the organizational structure of the organization.

Commentary:

This section provides a legal basis for the organization of an association of credit unions. In some countries this may be unnecessary if associations can be formed under a general law, such as the companies' code. It is preferable that legislation for this type of second-tier organization be included in the provisions of the Credit Union Act. While there may be a unique need for multiple associations in a country, there are significant economic and strategic benefits to financial cooperatives having a single strong voice at a national level.

Membership in the second-tier organization is voluntary. To hold the allegiance of the larger, more self-sufficient credit unions, the second-tier organization must assure them and their numerous members fair representation in its governance. Accordingly, voting by credit unions at meetings of the second-tier organization might be through a system of proportional voting based on number of members and/or total assets of member credit unions or through similar mechanisms such as voting within asset-size pier groups.

Proportional approaches to voting at second-level cooperative institutions is consistent with the International Cooperative Alliance's Cooperative Principal No. 2 "Democratic Member Control" which states: "In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner." See International Cooperative Alliance, Cooperative identity, values & principles (1995), available at <http://ica.coop/en/whats-co-op/co-operative-identity-values-principles>.

Terms sometimes used to designate a second-tier organization include: "league," "union," "central," "federation," "network" or "association."

10.15 Services of a Second-Tier Organization

Purpose:

To identify certain programs and services a second-tier organization may offer its members.

Content:

A second-tier organization shall advise and assist its credit unions by providing programs and services that will enable credit unions to more effectively serve members. These may include, but not be limited to, such areas as education and training, management consultation, accounting and auditing services, standardized systems, brokering of investments, supplies and forms, marketing and procurement, risk management, payment and settlement systems, insurance, liquidity management and advocacy of credit unions before the government and the general public.

Commentary:

Generally, member credit unions would determine the specific services they desire the second-tier organization to furnish. Some second-tier organizations provide a central finance facility as an integral part of the organization's program, either as a department, division or as a subsidiary corporation. In this situation, the second-tier organization would have to meet licensing and capital requirements as well.

10.20 Central Finance Facility

Purpose:

To authorize formation of a central finance facility for credit unions by establishing it as either an independent organization or as part of a second-tier organization.

Content:

1. A central finance facility may be organized under this Act with credit unions as its members. It shall be subject to all provisions of this Act and regulation not inconsistent with this section.
2. The purposes of a central finance facility are:
 - a. To accumulate and manage prudently the liquidity of its member credit unions through investment services and inter-lending when appropriate;
 - b. To act as an intermediary for credit union funds between members and other central finance facilities;
 - c. To obtain liquid funds from other credit union organizations, financial intermediaries and other sources in case of liquidity shortage situations;
 - d. To participate in regional or national central financial systems designed to foster the economic security and development of member credit unions;
 - e. To provide payment and settlement systems and correspondent services for its members; and
 - f. To perform such other services of benefit to its members which may be authorized by the Superintendent or Supervisory Body.

Commentary:

The key purposes of a central finance facility are set forth, namely: providing wholesale liquidity management, investment vehicles, financial intermediation and participation in regional or national central financial systems, payment clearing and settlement and as the lender of last resort for credit unions. Subsection 2(f) also permits the Superintendent or Supervisory Body to authorize additional services as changes in the financial marketplace may dictate.

A central finance facility would draw its membership primarily from credit unions, but could also include credit union organizations and other groups serving credit unions. These might be a credit union service organization, a credit union insurance company, a bank or other financial institution primarily serving credit unions. How the central finance facility is structured, i.e., as a stand-alone organization or as part of the

association of credit unions, depends on local conditions. However, caution should be taken to ensure that what is a financial endeavor is separate from political pressures.

An ultimate goal for credit unions should be for them to have direct access to national clearing and settlement systems and a country's central bank liquidity borrowing facilities. A central finance facility is still desirable to augment this direct access and make such systems more cost effective for credit unions.

10.25 Powers of Central Finance Facility

Purpose:

To permit a central finance facility to exercise certain additional powers and privileges.

Content:

1. A central finance facility may exercise the powers and privileges of any other credit union registered under this Act, except that it may only serve member organizations and not natural persons. Furthermore, the regulations may authorize it to exercise such additional powers and privileges as are necessary for it to fulfill its purposes as set forth in Section 10.20, notwithstanding any limitations or restrictions imposed on credit unions elsewhere in this Act.
2. A central finance facility is subject to the Investment of Funds standards in section 8 and capital adequacy and allowances for loan losses standards of section 9, unless there are special reserve requirements established for the facility in regulations by the Superintendent or Supervisory Body.

Commentary:

A central finance facility, because of its unique role as liquidity manager for other credit unions, requires broader powers and relief from some restrictions imposed on natural-person credit unions. These would be enumerated in the by-laws developed and approved by the Superintendent or the Supervisory Body. These added powers are critical to the central credit union gaining access to external sources of liquidity and participating in any regional or national networks of centrals.

Prohibited from serving natural persons, a central finance facility would not be in competition with its own member credit unions.

10.30 Risk Mitigation of a Central Finance Facility

Purpose:

To outline the risk mitigation framework for a central finance facility.

Content:

Subject to the Act and regulations:

1. The regulatory capital adequacy requirement for a central finance facility must be no less than what is required for a credit union as measured as a percentage of risk weighted assets.
2. The investment objective of a central finance facility is to preserve capital and ensure liquidity for its members.
3. Subject to regulatory approval, the board of the central finance facility should develop risk management, investment and capital policies.

Commentary:

Central finance facilities by their very nature concentrate the resources and potential for operational and financial gains and losses among credit unions. It will require advanced skills to operate and oversee these organizations.

PART XI

POWERS OF THE SUPERVISOR

Part XI outlines the basic considerations required for regulating and supervising credit unions. A deposit insurance system is included as a tool of financial stability. There can be different organizational arrangements for carrying out these responsibilities. Although an independent self-regulatory organization with delegated authority from government or a deposit guarantee corporation may be appropriate for registering, supervising and regulating credit unions in some environments, the framework provided in the Model Law recommends that these activities be carried out by the government's financial institution regulator. Within this agency, a specialized department is established for credit unions. Alternatively, a stand-alone credit union regulatory agency may be established.

11.10 Supervision

Purpose:

To designate the agency of government responsible for the licensing, regulation and supervision of credit unions and second-tier organizations.

Content:

1. The Ministry of Finance [*or other designated Ministry that regulates financial institutions*] is responsible for the regulation and supervision of credit unions and credit union service organizations registered under this Act.
2. There is a specialized department within the Ministry [*or other appropriate administrative unit*] for credit unions to which the Minister delegates administrative responsibility for regulation of credit unions and second-tier organizations.
3. The Department of Credit Unions is headed by a Superintendent, Registrar or Chairman appointed by the Minister. The Superintendent shall have a working knowledge of financial institutions, and preferably of credit unions, which may be derived from governmental, academic or professional experience.

Commentary:

As financial institutions, credit unions manage substantial funds belonging to others, namely their members. This responsibility requires credit unions to be supervised by a knowledgeable external agency. There can be different organizational arrangements for carrying out these responsibilities.

Although an independent self-regulatory organization with delegated authority from government may be appropriate for registering, supervising and regulating credit unions in some environments, the Model Law recommends that these activities be carried out by an independent financial regulator accountable to government.

The recommended approach is for credit unions to be regulated by the Minister/agency that regulates financial institutions, or by an agency that only regulates credit unions such as the US National Credit Union Administration and Canadian provincial credit union regulatory agencies.

11.15 General Powers of the Superintendent

Purpose:

The regulation and oversight powers of the Superintendent are detailed in this section. These include the ability to issue regulations, to set prudential standards for credit unions and second-tier organizations, to obtain information from credit unions, including regular reports, and to carry out periodic inspections and the supervision of credit unions and second-tier organizations.

Content:

1. The Superintendent or Supervisory Body will prescribe regulations to implement this Act and set prudential

standards for credit unions pursuant to the procedures of Title XII of this Act. The regulations shall serve to foster and maintain an effective level of credit union services and the security of member accounts.

2. A credit union shall make all reports required by the Superintendent in a timely manner.
3. The Superintendent can inspect, or cause to be inspected, any credit union, central finance facility or critical service provider to credit unions, at periodic intervals based on the risks of the organization to be inspected.
 - a. A credit union, its officers, employees and agents must give the Superintendent or his/her representatives full access to inspect all funds, securities, books, papers, records and other sources of information under their control.
 - b. A report of the findings of the inspection shall be presented to the board of directors of the credit union.
 - c. In place of making an inspection, the Superintendent may accept a report on the credit union's condition made by an independent professional or by a professional working for the Association of Credit Unions. Such persons must be approved by the superintendent. The scope of the inspection shall be as prescribed by regulation of the Superintendent or Supervisory Body.
 - d. The Superintendent will require each credit union to have an annual audit carried out by a qualified audit firm. The scope of the audit should be in line with Internationally Accepted Auditing Principles.

Commentary:

Credit unions need a clear understanding of how their operations are subject to regulation. Regulatory powers of the Superintendent should be explicitly defined. Any attempt to regulate in unauthorized areas will then be beyond the law.

In promulgating regulations, as well as in other major regulatory actions, the Superintendent must give advance notice to credit unions (Subsection 1a). It is anticipated that the Superintendent will go beyond mere notice and may want to create an advisory council comprised of key stakeholders from the sector.

The primary purpose of the government inspection (typically referred to as an "examination") is to review the soundness of management, governance, finance and policy decisions affecting the liquidity, and solvency of the credit union. Compliance with the law and regulatory prudential limits is also a major focus of an inspection.

Thus a credit union's loans and investments would be checked for their legality. When an inspection shows unsound or unlawful practices, the Superintendent normally would look not to the courts, but to an adverse inspection report to impress on the board of directors and management the need to take corrective action with the option of administrative remedies if necessary.

Although considerable verification of accounts and records must be performed, the inspection is not to be considered an audit, but rather an analysis of the solvency, compliance and operations of the institution. The audit responsibility in a credit union lies with the Audit Committee and an external auditor engaged by the credit union. (See Section 5.20.)

Annual inspections may be deemed sufficient based on the condition of the credit union and the activities it is engaged in. However, it is recognized that inadequate staffing or unusual regulatory pressures may prevent strict adherence to that norm. For these reasons, this Model Law specifies only that inspections should be performed at periodic intervals based on the risk that the credit union presents. It is essential that the inspection process include a review of delinquency and an assessment of the adequacy of the provision for loan losses.

Key responsibilities of supervision are to establish prudential regulations (See Section 2.35), to monitor and measure credit union performance against the standards and to take steps to ensure that credit unions take corrective action in order to manage risks. It is essential therefore that the supervisor establish a reporting system to regularly monitor the performance of all credit unions monthly, quarterly or bi-annually through an off-site examination process. It is essential that timely reporting be required and enforced to enable prudential and compliance issues to be identified in time to be remedied. Reliance solely on an annual audit and/or inspection is insufficient to facilitate sound supervision.

It is essential therefore that the Superintendent's Department have a specialized monitoring section responsible for the regular review of credit union performance and that there be a provision in legislation requiring credit unions to forward

to the Superintendent periodic financial statements and other operating data in a timely manner.

11.20 Enforcement Powers of the Superintendent

Purpose:

The existence of regulations and legislation requirements alone is not enough to ensure the sound and safe management of a credit union and protection from loss of members' savings and deposits. It is also essential that powers exist to compel compliance with legislation.

Content:

1. The Superintendent may issue financial penalties, cease-and-desist orders or a directive to a credit union having first determined from evidence that the credit union is:
 - a. engaged in or is about to engage in an unsafe or unsound financial practice; or
 - b. violating a provision of any law, regulation or written order of the Superintendent.
2. On the basis of evidence, the Superintendent may take remedial actions to change the course of direction. This may include written notices, cease and desist orders, removal of board and/or management, receivership, merger or liquidation. The Superintendent may call a special general meeting of the members for the purpose of electing a successor for any officer, director or committee member who has been removed from office or may itself select successors.
3. The Superintendent may restrict the withdrawal of deposit accounts from a credit union after having determined such action is necessary to protect the interests of members.
4. The Superintendent may institute legal proceedings of either a criminal or civil nature, through the Department of [appropriate government prosecutory agency], against any officer, director, committee member, employee or agent of a credit union when there is evidence that such person has committed a violation of a law, regulation or order or has committed any of the criminal offenses specified in Section 14.20.
5. The Superintendent may exempt a credit union from compliance with a specific requirement of the Act or regulations for a specified period of time.
6. The Superintendent may also exercise the same powers enumerated in this section in relation to any central finance facility.

Commentary:

These are substantial enforcement powers at the disposal of the Superintendent or Supervisory Body short of the ultimate liquidation of a credit union. Such measures attempt to remedy unsafe and unsound practices while preserving the credit union as an institution.

The major enforcement authority of the Superintendent will come from the existence of the ultimate sanction: placing the credit union under administration. The threats of financial penalty, removal from office and loss of control of a credit union usually will force a poorly functioning board and/or management to make changes and take corrective action.

11.25 Receivership

Purpose:

To authorize the Superintendent to place a credit union under receivership when it fails to implement directed remedial measures, remains in violation of the laws, or is insolvent when it is necessary to conserve the assets of the credit union or to protect the interests of the members.

Content:

1. When a credit union is found to be operating in an unsafe and unsound manner, fails to comply with its capital or liquidity requirements, is or is near insolvency, is in violation of the legislation, or when a credit union fails to

implement remedial measures ordered by the Superintendent, the Superintendent may take prompt corrective action to place the credit union under administration and appoint a representative to administer the credit union. This administrator will take immediate possession and control of the business and assets of the credit union.

2. The Superintendent or Administrator may remove the officers, directors, committee members or employees from office, or the Superintendent or administrator may prohibit or restrict them from exercising any of their respective powers or authority when he/she believes the exercise of those powers would contribute to the unsafe or unsound conduct of the credit union's officers or cause the credit union financial difficulty.
3. Within 15 calendar days of the order to place the credit union under receivership, the credit union's board of directors may appeal the decision to a court of competent jurisdiction as a final agency action subject to judicial review under Section 12.35.
4. Unless the credit union prevails in the appeal, the Superintendent may maintain possession and control of the credit union and its receivership until one of the following occurs:
 - a. The Superintendent permits it to be released from receivership and to resume normal operations under the authority and direction of the board of directors, subject to any terms and conditions established by the Superintendent.
 - b. If the Superintendent has been able to correct the issues causing the credit union to be placed under receivership, but considers that the credit union cannot continue long-term as a viable stand-alone organization, he/she may merge the credit union with another credit union, provided it is desired by the receiving credit union, it offers an opportunity to safeguard members' savings and deposits, and makes possible the continuation of credit union services.
 - c. If efforts to merge the credit union with another fail, or the Superintendent determines that this would not be prudent, the Superintendent can place the credit union in involuntary liquidation as provided in Section 11.35.

Commentary:

Receivership, with the ultimate threat of forced liquidation, is the severest sanction that the Superintendent may exercise. Although the Superintendent takes over legal control of the credit union, he/she maintains the right to allow the board and management to continue to administer the affairs of the credit union to the degree he/she considers appropriate.

The key factors affecting this decision will be the nature of the issues requiring resolution and the least costly solution that can be implemented. The use of liquidation is often the costliest solution and should be avoided as much as possible. The objective of receivership should always be to find the least costly method of ensuring that remedial action is taken while protecting members' savings and deposits. It is essential that any measures taken should ensure that the confidence of both the members of the credit union and the overall movement is maintained.

While this section allows for an administrative appeal of a decision, it does not preclude a credit union from also seeking an independent judicial review of such sanctions.

11.30 Merger by the Superintendent

Purpose:

To permit the Superintendent to assist the merger of a credit union with another credit union as an alternative to liquidation.

Content:

1. The Superintendent may issue an order of a credit union which is insolvent or in danger of becoming insolvent, or which is determined to be neither viable in the long-term nor capable of meeting prudential standards, to either merge with any other registered credit union that agrees to the merger or be liquidated. To issue such an order, the Superintendent must be satisfied that:

- a. The merging credit union cannot reasonably be expected to operate as a viable stand-alone organization;
- b. Other alternatives are not reasonably available;
- c. The interest of members would be best served by the merger;
- d. The merger is acceptable to the receiving institution; and
- e. That the merger would not severely impact the financial condition of the receiving credit union.

Commentary:

Rather than liquidate a distressed credit union, it is usually preferable to merge it with a solvent credit union. However, this process would only be invoked once the Superintendent had ensured that remedial action had been carried out to the extent possible. Such a merger must not cause an adverse impact on the receiving credit union, which could seriously affect the financial health or viability of the combined institution.

11.35 Involuntary Liquidation of a Credit Union

Purpose:

To authorize the Superintendent to place an administered credit union into liquidation.

Content:

1. If the Superintendent considers that a credit union in receivership is not viable in the longer term and that there is no suitable or willing merger partner, the Superintendent may issue an order to liquidate the credit union.
2. Upon being placed in involuntary liquidation, the credit union must cease all operations. Under the direction of the liquidating agent, the credit union shall continue in existence in order to discharge its debts, pay operating expenses, collect money owed to it, distribute its assets and perform all acts required to wind up its affairs.
3. The liquidating agent shall distribute the assets of the credit union or the proceeds of any disposition of the assets as follows:
 - a. First - Secured creditors up to the value of their collateral;
 - b. Second - Costs and expenses incidental to liquidating the credit union;
 - c. Third - Wages due to employees of the credit union; and
 - d. Fourth - Owners of deposit accounts.
 - e. Fifth - General creditors, secured creditors to the extent their claims exceed the value of their collateral.
 - f. Sixth - Holders of subordinated debt.
 - g. Seventh - Holders of preferred shares, up to par value.
4. Assets then remaining shall be distributed *pro rata* to the holders of the credit union's ownership shares based on the members' share holdings.

Commentary:

This step would be taken once the Superintendent had exhausted all attempts at rehabilitation and concluded that no other options are available. Liquidation will almost certainly result in financial losses to members but, in the unlikely event that residual value exists after all claims have been paid, the remaining assets of the institution must be distributed to the members of the credit union based on their equity ownership of the institution as evidenced by their Ownership Shares.

11.40 Establishment of a Deposit Insurance System

Purpose:

To authorize and define the objectives in establishing a government-sponsored Deposit Insurance System.

Content:

1. A deposit insurance system shall be organized and membership shall be mandatory for all credit unions registered under this Act. The system shall be accountable to the Ministry of Finance [*or name of other appropriate government agency*] and have the full faith and credit of the national government. Its purpose shall be to provide compensation to depositors in the event of the insolvency of their credit union and to take preventative action as needed to prevent such failures.

Commentary:

A deposit insurance system is designed to act as a guarantee to depositors. It provides protection and compensation of depositors' savings if their financial institution collapses. A deposit insurance system is only one part of the protection of deposits: effective regulation and the provision of programs to prevent a collapse, also contribute to the protection of savings. A well-designed and well understood deposit insurance scheme contributes to the stability of a country's financial system by reducing the incentive for depositors to withdraw their deposits following a loss of confidence in their institution or financial system.

Membership of a deposit insurance system should be compulsory for the entire sector, to avoid adverse selection occurring. Entry requirements may be established as a condition of membership.

To discourage high-risk behavior by credit union directors and management, the amount of coverage available can be limited to an amount of deposits, directors and management can be excluded from coverage and risk-based premiums can be charged. Coverage levels for credit union depositors should at least be on par with coverage levels for other depository financial institutions in a given country.

Privately owned deposit insurance is an option that may be considered alongside a government-sponsored deposit insurance system.

While this is an acceptable model, the law should require any privately owned deposit insurance system to be approved by the appropriate regulator(s). Coverage provided, the form of governance, safeguarding of the fund and control of moral hazard should be carefully considered by a Superintendent considering the approval of a private deposit insurance system.

A deposit insurance system is different from a Stabilization Fund whose aim is to enable the continuation of a struggling credit union. The Model Law does allow for the establishment of a Stabilization Fund but it is not a legal requirement. The core difference between a Stabilization Fund and a Deposit Insurance System is that depositors are provided with reimbursement of their funds if an institution fails under a Deposit Insurance System whereas a Stabilization Fund exists to maintain a credit union's operations, and it does not provide reimbursement of funds if the credit union eventually fails.

11.45 Governance of the Deposit Insurance System

Purpose:

To provide for a representative body to control and govern the Deposit Insurance System.

Content:

1. The Credit Union Deposit Insurance System shall be administered by a five-person board of directors consisting of:
 - a. Two members selected by government, one being the Superintendent of credit unions or a designee;
 - b. Two members recommended by credit unions from the credit union sector and appointed by government; and
 - c. A chairperson who is appointed by government.
2. The board of directors shall elect such other executive officers as the bylaws provide. The board shall also appoint a chief operating officer and delegate to this person the responsibility for day-to-day administration of the Deposit Insurance System.

3. With the exception of the Superintendent of credit unions, who shall occupy a permanent seat, all other board members shall serve 4 year rotating terms.

Commentary:

The governing board of the Deposit Insurance System should be representative of the groups within the credit union movement most concerned with financial solvency issues, e.g., the regulator, central finance facility and government. The governance framework described above is appropriate for a government-sponsored system. In a privately owned deposit insurance system the balance of power should lie with the private sector, not government.

Inter-relationships between the Deposit Insurance System and the Superintendent should be explicit to ensure sufficient firewalls exist and to allow for appropriate information sharing to occur.

11.50 Powers of the Deposit Insurance System

Purpose:

To identify the principal measures that the Deposit Insurance System may use to accomplish its purposes.

Content:

1. The board of the Deposit Insurance System is empowered to do any or all of the following in order to maintain or restore the solvency of credit unions or to meet claims of their creditors and depositors. The Deposit Insurance System may:
 - a. In coordination with the Superintendent or Supervisory Body, establish prudential standards as a condition of entry and approve or reject membership in the Deposit Insurance System.
 - b. Undertake on-site inspections and/or require a credit union to submit reports on its financial affairs to enable the System to evaluate the credit union's financial condition.
 - c. Make loans, advances and grants to a credit union that requires financial assistance for the purpose of stabilization.
 - d. Purchase all or any portion of the assets of a credit union or assume all or any portion of its liabilities.
 - e. Supervise, administer and reorganize the affairs of a credit union that is in financial difficulty.
 - f. Serve as liquidating agent of a credit union that is in the process of winding up its affairs under Section 11.35 of this Act.
 - g. Determine and levy fees and/or additional capital contributions on credit unions for its services and to provide guaranteed compensation to depositors in the event of the collapse of a credit union.
 - h. Exercise such incidental powers as shall be necessary or requisite to enable it to effectively carry out its purposes, including the power to make contracts, to sue and be sued, to borrow money and to invest its excess funds.
 - i. Require or oversee a credit unions' workout plan to avert or alleviate financial difficulties.
 - j. Invest the premiums in high quality investments that seek to preserve capital.
 - k. Provide public notice that a credit union is being liquidated and how depositors are to be compensated.
 - l. Pay compensation on verifiable claims from members.

Commentary:

The Deposit Insurance System should have the power to require financial reports, set prudential standards that are coordinated with the Superintendent or Supervisory Body and levy fees and/or additional capital contributions. The establishment of prudential standards either by the deposit insurance system or the Superintendent and the ability to require financial reports provides safeguards to protect the system. The ability to levy fees and/or additional capital contributions on those protected by the System ensures that there are always sufficient funds available to enable claims for compensation to be met and minimum equity ratios maintained in the fund.

11.55 Financing the Deposit Insurance System

Purpose:

To identify the sources of funds for the Deposit Insurance System.

Content:

1. Over the first five-year period of its existence each member credit union shall make an initial capital contribution to the Deposit Insurance System to be fixed at a percentage of the credit union's deposits [*or other appropriate basis*].
2. The Deposit Insurance System may also assess each member credit union an annual levy. The Deposit Insurance System board may waive the annual assessment when the amount accumulated in the Deposit Insurance System equals a percentage of the book value of all credit union member protected deposits, as fixed by regulation of the Superintendent. The board may, from time to time, levy special assessments to cover the cost of providing compensation or provide dividends back to the credit unions if the fund reaches a value above a percentage of the book value of all credit union deposits.

Commentary:

The amount of the initial capital contribution to the Deposit Insurance System should be specified in the Act itself or in the regulations. In addition, it will be necessary to charge an annual levy until the total amount available in the fund reaches a specified percentage of protected deposits. A fund equivalent to at least 1.57% of insurable deposits is the average equity ratio among a sampling of credit union insurance systems globally. Depending on the volatility of a market and the capitalization levels, loan loss provisioning requirements and earnings of credit unions in it, a target equity ratio may need to be greater than this, or could be lower. This government-sponsored fund is designed to have the full faith and credit of the national government to meet short falls should the funds balance be insufficient to meet demands on it. In a privately owned deposit insurance system, back up by lines of credit from the private sector or government are also encouraged. Limitations on the annual assessment and any special assignment are better spelled out in the regulations or the bylaws of the Deposit Insurance System.

Other sources of funds for the Deposit Insurance System would include: (1) money realized from assets purchased from credit unions and assets received from credit unions in the process of dissolution; (2) all contracts made by the system in the exercise of its powers; and (3) interest and dividends on money invested.

Contributions to the establishment and ongoing levies for the Deposit Insurance System may be recognized as an asset on the balance sheet of the credit union rather than an expense to its income statement if these payments are redeemable from the Deposit Insurance System. Alternatively, the fund could be established on an ex ante basis and premiums be charged and recognized as a current period expense.

Contributions that remain as an asset of the balance sheet of the credit unions are a less costly way for credit unions to build and maintain a fund. However, in periods of stress, if additional capital contributions are required, and the contributions that are assets on the balance sheet are re-evaluated downward, it can compound stress in an organization.

The moral hazard introduced through an explicit safety net system such as deposit insurance, should be mitigated by examination and monitoring of risk to the fund, placing limits on the amounts insured, excluding directors and management from coverage, implementing risk-adjusted premiums and demonstrating a willingness to take legal action against directors, where warranted.

PART XII

RULE OF LAW, TRANSPARENCY AND ADMINISTRATIVE PROCEDURE

Setting forth the substantive and procedural administrative law standards applicable to the Superintendent or Supervisory Body and its actions.

12.10 Supervisory Rulemaking and Guidance Authority

Purpose:

To clarify which forms of agency issuances have the force of law and which are non-binding “guidance” documents.

Content:

1. The Superintendent or Supervisory Body may adopt rules to interpret the provisions of this Act as set forth by this Part and by Section 11.15. Rules must be adopted using the public notice and comment procedures in Sections 12.15, 12.20, or 12.25, and these rules have the force of law. The Superintendent or Supervisory Body may at its discretion adopt the rule pursuant to the Notice and Comment procedures found in Section 12.15 or the Public Notice and Hearing procedures found in Section 12.20, or the Emergency Rule procedures of Section 12.25 if the good cause requirements of that Section are met.
2. The Superintendent or Supervisory Body may issue non-binding guidance documents, such as manuals or letters setting forth best practices, general statements of policy, or rules of agency organization, procedure, or practice. Guidance documents are not subject to the public notice and comment procedures in Sections 12.15, 12.20, or 12.25, and therefore do not have the force of law. The Superintendent or Supervisory Body cannot require a credit union to comply with non-binding guidance, even as a safety and soundness requirement, because such guidance does not have the force of law.

Commentary:

This section sets forth the authority for the credit union Superintendent or Supervisory Body to adopt rules and regulations in order to establish a rule book to interpret ambiguous provisions of the Model Law; such rules must be subject to public consultation. This section would also permit the supervisor to issue without public consultation non-binding guidance that does not have the force of law.

Rules, also called regulations or a rule book, are administrative interpretations of this Model Law adopted through a public consultative process. These administrative rules are a type of law. The Superintendent or Supervisory Body’s agency head is the authority empowered to issue proposed and final versions of rules.

Pursuant to Section 12.35, guidance documents which the Superintendent or Supervisory Body treats as binding policy in practice are rules pursuant to subsection (a) and must be subject to public notice and comment pursuant to Sections 12.15., 12.20, or 12.25 prior to becoming binding legal requirements.

12.15 Consultations on Prospective Rules Using Public Notice and Comment

Purpose:

To preserve the democratic process and rule-of-law in the context of quasi-legislative agency rulemaking.

Content:

1. If the Superintendent or Supervisory Body elects to promulgate a rule using Public Notice and Comment procedures, the Superintendent or Supervisory Body shall at least 60 days before the adoption of a rule file notice of the proposed rulemaking for publication in the *[government’s administrative bulletin or a newspaper of general circulation]* as well as its website. The notice must include:
 - a. A short explanation of the proposed rule, its legal authority, and the Supervisor or Supervisory Body’s de-

tailed reasoning regarding why a new regulation is necessary and in the public interest;

- b. The text of the proposed rule; and
 - c. How a person may comment on the proposed rule in writing and the date until which comments will be accepted.
2. An agency proposing a rule shall specify a public comment period of at least 60 days after publication of notice of the proposed rulemaking during which a person may submit information and comment on the proposed rule. The information or comment may be submitted in an electronic or written format. The agency shall consider all information and comment on a proposed rule which is submitted pursuant to this subsection within the comment period.
 3. An agency may consider any other information it receives concerning a proposed rule during the rulemaking. Any information considered by the agency must be incorporated into the administrative record. The information need not be submitted in an electronic or written format. Nothing in this section prohibits an agency from discussing with any person at any time the subject of a proposed rule.
 4. A Superintendent or Supervisory Body may choose to hold a public hearing pursuant to Section 12.20 in addition to using the public notice and comment procedures of Section 12.15.
 5. After the Superintendent or Supervisory Body's staff has reviewed all comments and other relevant information, the Superintendent or Supervisory Body may issue a final version of the rule. The final version of the rule shall contain a preamble discussing the public comments and other information received and set forth the reasons why or why not the Superintendent or Supervisory Body has decided to, or declined to make, changes to the rule requested by the public.
 6. If the final rule contains changes from the proposed rule which are not a logical outgrowth of the proposal, the Superintendent or Supervisory Body shall initiate a new consultative process pursuant to Sections 12.15, 12.20, or 12.25 regarding the provisions of the final rule which are not a logical outgrowth of the proposal.

Commentary:

This section sets forth the rules for credit union supervisors to conduct a public consultation through a written notice and comment rulemaking procedure, whereby credit unions, associations, and other interested members of the public can submit comment letters stating their views on the proposal. This procedure can be used on its own or in conjunction with a public hearing.

Administrative rulemaking is an exercise by the Superintendent or Supervisory Body of quasi-legislative power and, as such, should be subject to a quasi-democratic process by way of a public consultation. Promulgating rules via public consultations is the standard practice in mature political systems including the European Union and many national and sub-national jurisdictions, and a public consultation using written comments from the public is the most frequently used procedure. A Superintendent or Supervisory Body may elect to utilize the public consultative procedures of Sections 12.15 and 12.20 concurrently.

If a significant number of comments suggest a specific revision to the proposal, the Superintendent or Supervisory Body should in general make that revision unless the Superintendent or Supervisory Body can reasonably articulate in the final version of the rule why the suggested changes would not be in the public interest and/or would not be consistent with maintaining a safe and sound credit union system.

12.20 Consultations on Prospective Rules Using Public Hearings

Purpose:

To permit consultations through public hearings.

Content:

1. If a Superintendent or Supervisory Body elects to promulgate a rule using the Public Notice and Hearing procedures, the Superintendent or Supervisory Body shall at least 30 days before the adoption of a rule file notice of the proposed rulemaking and hearing for publication in the government's administrative bulletin or a newspaper of general

circulation] as well as its website. The notice must include:

- a. A short explanation of the proposed rule, its legal authority, and the Supervisor or Supervisory Body's detailed reasoning regarding why a new regulation is necessary and in the public interest;
 - b. The text of the proposed rule; and
 - c. Where and when the public hearing will be held, as well as a statement that members of the public may make comments at this hearing.
2. A hearing must be open to the public and recorded, and the agency shall produce a written transcript of the comments made at the hearing which shall be posted for public inspection on the Superintendent or Supervisory Body's website within a reasonable period of time.
 3. A hearing must be held at least 20 days after notice of the hearing's location, date, and time is published in the *[administrative bulletin or newspaper of general circulation]* and on the Superintendent or Supervisory Body's website.
 4. One or more representatives from the Superintendent or Supervisory Body shall preside over a hearing on a proposed rule. The agency must consider all information presented during the hearing in its deliberative process, and must include that information, including but not limited to the transcript required by Subsection 2 of this Section, as part of the administrative record of the rulemaking.
 5. A Superintendent or Supervisory Body may choose to utilize the public notice and comment procedures of Section 12.15 in addition to holding a public hearing pursuant to Section 12.20.
 6. After the Superintendent or Supervisory Body's staff has reviewed all comments and other relevant information introduced into the administrative record, the Superintendent or Supervisory Body may issue a final version of the rule. The final version of the rule shall contain a preamble discussing the public comments and other information received and set forth the reasons why or why not the Superintendent or Supervisory Body has decided to, or declined to make, changes to the rule requested by the public.
 7. If the final rule contains changes from the proposed rule which are not a logical outgrowth of the proposal, the Superintendent or Supervisory Body shall initiate a new consultative process pursuant to Sections 12.15, 12.20, or 12.25 regarding the provisions of the final rule which are not a logical outgrowth of the proposal.

Commentary:

This section sets forth the rules for public consultations using public hearings, where credit unions, etc., would express their view on the proposed rule at a hearing. The public hearing procedures can be used on their own or in conjunction with a written notice and comment consultation.

Public consultations using public notice and hearings is another manner whereby the Superintendent or Supervisory Body can subject a proposed rule to a quasi-democratic process in order to maintain better the rule of law. In some jurisdictions, especially one that are geographically small, public hearings may be more useful and convenient for many credit unions and other interested members of the public. A Superintendent or Supervisory Body may elect to utilize the public consultative procedures of Sections 12.15 and 12.20 concurrently.

If a significant number of comments suggest a specific revision to the proposal, the Superintendent or Supervisory Body should in general make that revision unless the Superintendent or Supervisory Body can reasonably articulate in the final version of the rule why the suggested changes would not be in the public interest and/or would not be consistent with maintaining a safe and sound credit union system.

12.25 Emergency Rules

Purpose:

To permit swift administrative action in an emergency on an interim basis.

Content:

1. If the Superintendent or Supervisory Body for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that the notice and public consultation procedures of sections 12.15 or 12.20 are impracticable, unnecessary, or contrary to the public interest, the Superintendent or Supervisory Body may issue a final rule which has immediate effect and follow the consultative procedures of subsection (2).
2. When a Superintendent or Supervisory Body issues an Emergency Rule under subsection (1), the final rule shall include a notice and solicitation for public comments following the procedures of Section 12.15 notwithstanding that the emergency rule already has legal effect.

Commentary:

This section allows the supervisor to issue rules with immediate effect in emergencies, but also requires the supervisor to immediately undertake a public consultation using written comments, and possibly later amend the emergency rule in response to input from credit unions and other interested members of the public.

A Superintendent or Supervisory Body should utilize these Emergency Rule procedures sparingly and only when truly necessary, such as during a financial crisis. Even though an Emergency Rule has immediate effect when issued, it must nonetheless be subject to public consultation and possible revision as would a rule adopted pursuant to Section 12.15.

12.30 Judicial Review of Rules Adopted Through Public Consultations

Purpose:

To promote the rule-of-law and accountability in the rulemaking process.

Content:

1. With respect to rules adopted pursuant to Sections 12.15, 12.20, or 12.25, one or more credit unions regulated by the Superintendent or Supervisory Body, or an association of regulated credit unions, may under this section initiate judicial review of any final rule which effects the operations of the credit union(s) or association. Such judicial review actions should be brought in *[Name of Court]* for the geographic location where the credit union's home office is located, or the appropriate court in the jurisdiction's capital.
2. A reviewing court shall defer to the Superintendent or Supervisory Body's rule unless:
 - a. The court holds that the statutory provisions under which the Superintendent or Supervisory Body promulgated the rule is unambiguous and therefore is not open to interpretation;
 - b. A different statutory provision of the Act from the one claimed by the Superintendent or Supervisory Body as the legal basis of the rule addresses the subject matter of the rule more specifically than the provision cited by the Superintendent or Supervisory Body as the legal basis of the rule;
 - c. The court holds that the Superintendent or Supervisory Body's interpretation of an ambiguous provision of the Act is unreasonable as a legal matter; or
 - d. The court finds that the Superintendent or Supervisory Body's rule is unreasonable based on the facts and circumstances reflected in the Superintendent or Supervisory Body's administrative record of the rulemaking and its public consultation(s), or the court finds that the Superintendent or Supervisory Body has not taken a hard look at the salient factual issues, or the court finds that the Superintendent or Supervisory Body has not provided a complete and accurate administrative record of the consultative proceedings.

Commentary:

This section allows credit unions and credit union associations to seek court review of rules adopted by the Superinten-

dent or Supervisory Body using any of the three public consultative processes outlined above. The standard of judicial review is modeled on the so-called Chevron Doctrine established by the U.S. Supreme Court to interpret regulations adopted under U.S. Administrative Procedure Act that have been subject to a public consultation. See, e.g., Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984); see also 5 U.S.C. §§ 551-596.

Pursuant to Section 12.30, a rule may only interpret provisions of this Act that are ambiguous. A Superintendent or Supervisory Body's reasonable interpretation of an ambiguous provisions of the Act will generally be upheld by a reviewing court unless the Superintendent or Supervisory Body's interpretation is unreasonable based the facts found in the agency's record of the applicable rulemaking and public consultation.

Under the legal principles of *expressio unius est exclusio alterius* ("the mention of one thing excludes the alternative") and that the more specific statutory provision trumps more general statutory provisions, a Superintendent or Supervisory Body may not validly use a general provision of the Act to promulgate a rule which addresses subject matter that a different section of the Act addresses more specifically.

In determining whether a rule interpreting an ambiguous provision of the Act is unreasonable as a legal matter, the court should examine whether the agency has followed all applicable procedural requirements as well as the overall effect of the rule in the context of promoting safe and sound credit unions, the jurisdiction's laws and legal traditions concerning property rights, due process and the rule of law, and notions of fairness and justice.

In determining whether a rule is factually reasonable, the court should limit its factual inquiry to the administrative record which resulted from the Superintendent or Supervisory Body's public consultative process under Sections 12.15, 12.20, and/or 12.25 unless the court determines that the Superintendent or Supervisory Body has not provided a complete and accurate record of the consultative proceedings.

12.35 Judicial Review of Other Agency Actions

Purpose:

To promote the rule of law and accountability with respect to final agency actions other than rulemaking.

Content:

1. One or more credit unions regulated by the Superintendent or Supervisory Body, or an association of regulated credit unions, may under this section initiate judicial review of any final agency action that affects the credit union (s) in question and/or one or more credit union(s) that are members of the association in question.
2. The reviewing court shall grant deference to the Superintendent or Supervisory Body's factual findings unless:
 - a. The court finds that the agency has not taken a hard look at the salient factual issues; or
 - b. The court finds that the agency's factual findings are arbitrary and capricious.
3. With respect to rules adopted through public notice and comment pursuant to Sections 12.15, 12.20, or 12.25, the reviewing court shall review the validity of these legal interpretations as set forth in Section 12.30. The court shall not grant deference to the Superintendent's or Supervisory Body's legal interpretations unless the legal interpretation in question was promulgated using a public notice and comment procedure pursuant to Sections 12.15, 12.20, or 12.25.
4. In determining whether to uphold or set aside the Superintendent or Supervisory Body's final agency action, the reviewing court shall weigh the following factors:
 - a. The thoroughness of the agency's investigation;
 - b. The validity of its reasoning;
 - c. The consistency of its interpretation over time; and
 - d. Other persuasive powers of the agency such as its expertise as a financial regulator.
5. If the reviewing court sets aside the Superintendent or Supervisory Body's final agency action, the court may either:

- a. Rule that the agency action is void; or
 - b. May remand the matter to the Superintendent or Supervisory Body for further consideration in accordance with the court's instructions.
6. In the event that the reviewing court remands of the matter to the Superintendent or Supervisory Body for further consideration, the reviewing court shall retain jurisdiction over the matter and shall review the Superintendent or Supervisory Body's post-remand findings and conclusions regarding the matter pursuant to the requirements of this section .

Commentary:

This provision sets forth a standard for judicial review of final agency actions that is modeled on the U.S. Supreme Court's holding in Skidmore v. Swift & Co. 323 U.S. 134 (1944). This section gives any credit union or credit unions affected by a final agency action standing to invoke judicial review of that final agency action pursuant to this section. In addition, a credit union association has standing to invoke judicial review of a final agency action if that action affects one or more credit unions that are members of the association in question.

Legal interpretations contained in rules that the Superintended or Supervisory Body adopted through public notice and comment are review pursuant to Section 12.30. All other final agency actions—including factual findings—would be subject to review under this this section. A reviewing court should take a hard look at the agency's factual findings, and only grant judicial deference to the agency's legal interpretation if those legal interpretations were adopting using the public notice and comment procedures set forth in Sections 12.15, 12.20, or 12.25.

Guidance that is not subject to a public consultative process should not be treated as binding law, and a reviewing court should not grant deference to agency legal interoperations unless they have been adopted in the form of a regulation through a public notice and comment. Treating guidance which has not been subject to a public consultative process as binding law is unfair and not consistent with the rule of law in a democratic society because such guidance is in effect a quasi-legislative rule, and regulated credit unions and other interested members of the public have not had an opportunity to express their views and submit factual evidence to the agency regarding the matter at issue as required by Sections 12.15, 12.20, or 12.25.

12.40 Freedom of Information

Purpose:

To promote transparency in the administrative process.

Content:

1. The Superintendent or Supervisory Body shall make available to the public on its website and at each of its offices the following materials:
 - a. Descriptions of its organization and how credit unions and other members of the public may obtain information or submit information or requests;
 - b. Statements of the general course and method by which its functions are channeled and determined, including the nature and requirements of all formal and informal procedures available;
 - c. Rules of procedure, descriptions of forms available or the places at which forms may be obtained, and instructions as to the scope and contents of all papers, reports, or examinations;
 - d. Substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency; and
 - e. Each amendment, revision, or repeal of the above.
2. A credit union or credit union association may not be adversely affected by any agency policy, rule, or practice which is not made available to the public pursuant to subsection (1), unless the credit union or association had actual knowledge of the policy, rule, or practice prior to the adverse action by the Superintendent or Supervisory Body and the adverse action would not be unfair under the totality of the facts and circumstances in question. Supervisory

contracts between the Superintendent or Supervisory Body and a credit union—such as Letters of Understanding and Agreement, Documents of Resolution, Memoranda of Understanding, and similar supervisory agreements in the nature of a contract—should be published on the Superintendent or Supervisory Body’s website prior the Superintendent or Supervisory Body taking adverse action against a credit union or association pursuant to the supervisory contract, but need not otherwise be made public.

3. Upon written request citing this provision of the Act, a credit union, credit union association, or other interested member of the public may request copies of non-public agency documents. This request must describe with particularity the specific documents or class of documents being sought. A Superintendent or Supervisory Body should withhold (such as by partially redacting a document) information:
 - a. Relating to the examination and supervision of a credit union;
 - b. Relating solely to the internal personnel rules and practices of the Superintendent or Supervisory Body;
 - c. Relating to national security;
 - d. Relating to an investigation of possible criminal and/or civil violations, including those related to money laundering, terrorist financing, or nuclear proliferation;
 - e. Relating to matters expressly exempted from public disclosure by a statute;
 - f. Relating to trade secrets and commercial or financial information obtained from a person and privileged or confidential;
 - g. Inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency; and
 - h. Personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.
4. Any reasonably segregable portion of a record shall be provided to any person requesting such record after deletion of the portions which are exempt under this subsection. The amount of information deleted, and the exemption under which the deletion is made, shall be indicated on the released portion of the record, unless including that indication would harm an interest protected by the exemption in this subsection under which the deletion is made. If technically feasible, the amount of the information deleted, and the exemption under which the deletion is made, shall be indicated at the place in the record where such deletion is made.
5. The Superintendent or Supervisory Body shall respond to the request for information within 180 days of receiving the request pursuant to subsection (1), including providing all information not exempt from disclosure pursuant to subsection (4). If, due to extraordinary circumstances such as war or an act of God, the Superintendent or Supervisory Body is not able to provide this information within 180 days, the Superintendent or Supervisory Body shall respond to the requestor in writing setting forth the reasons for the delay and the expected date when the information will be provided.
6. The Superintendent or Supervisory Body shall process information requests from bona fide members of the press, or which are needed to prevent loss of life, liberty, or property, on an expedited basis and make the information available to the requestor as soon as reasonably practicable.
7. A requestor may file suit in a court of competent jurisdiction to request the court to compel the Superintendent or Supervisory Body to respond to a request which has been unreasonably delayed beyond the time frame set forth in subsection (e) or, if applicable, subsection (f).
8. After the Superintendent or Supervisory Body has responded to a request, by providing some or all of the requested information, or stating that it will not release any of the requested information, the requestor may file suit in a court of competent jurisdiction to ask the court to review the Superintendent or Supervisory Body’s response for compliance with this Section of the Act. If the court determines that the Superintendent or Supervisory Body has not complied with this Section’s requirements, the court shall order the Superintendent or Supervisory Body to provide the requestor with the additional information required as soon as reasonably practicable.

Commentary:

This section is modeled on the United States of America's Freedom of Information Act and sets forth: (a) what materials the supervisor must always make available to the public; and (b) how credit unions and other interested members of the public can request non-public information, what non-public information the supervisor should disclose in response to such requests, and provisions for judicial review of such requests that are not granted fully or are unreasonably delayed.

In general, the Superintendent or Supervisory Body would be required to disclose the information within 180 days of the request with no possibility of an extension beyond that time frame. However, requests from the press or to "prevent loss of life, liberty, or property" (e.g., a credit union executive will be imprisoned overseas without this information, etc.) would jump the queue and be processed on an expedited basis.

PART XIII

VOLUNTARY CHANGES IN ORGANIZATION

Changes or weaknesses in a credit union's membership group, its own leadership or the regional economy in which it operates can sometimes force the credit union to restructure itself or to cease operations completely. This part sets forth procedures for merging one credit union with another, for consolidating two or more credit unions, for winding up the business affairs of a credit union entirely and for conversion of licensing to another law or legal form.

13.10 Merger and Consolidation

Purpose:

To provide a means for a credit union to merge or consolidate with one or more other credit unions.

Content:

1. A credit union registered under this Act may, with the approval of the Superintendent or Supervisory Body, merge with one or more credit unions. A merger may take place with one credit union designated as the continuing credit union and the other or others designated as merging credit unions. As an alternative, two or more credit unions may consolidate by structuring a new credit union into which all of the credit unions shall merge and be deemed merging credit unions.
2. A merger shall require a plan agreed upon by the board of directors of each credit union joining in the merger and approved by a majority of the members of the merging credit union either at a special membership meeting or by mail or electronic ballot.
3. Notice as to the merger action taken must be given to the Superintendent or Supervisory Body and deposit insurer, together with the plan of merger. The Superintendent or Supervisory Body must act to implement the request for the proposed merger within a reasonable time frame unless he/she is of the opinion that the merger could put member deposits at risk.
4. If the merger is approved by the Superintendent or Supervisory Body, all property, property rights and members' interest of the merging credit union shall vest in the continuing credit union without any instrument of transfer. All debts, obligations and liabilities of the merging credit union shall be deemed to have been assumed by the continuing credit union. The rights and privileges of the members of the merging credit union shall remain intact.
5. This section shall be construed to permit the merger of credit unions irrespective of their fields of membership.

Commentary:

This section offers the options of designating one of the merging credit unions as the continuing credit union or structuring a totally new credit union and designating it as the successor of the two merging credit unions. In a merger, the vote of a majority of the members voting on the plan is required. This vote may be conducted either at a special membership meeting or by mail or electronic ballot.

13.15 Voluntary Liquidation

Purpose:

To allow a solvent credit union to wind up its business affairs on a voluntary basis. Insolvent organizations would be subject to involuntary liquidations.

Content:

1. A credit union may liquidate voluntarily and wind up its affairs in the manner described in this section.
2. The board of directors must first adopt a resolution that is in the best interests of members recommending to the

members that the credit union be liquidated for the reasons indicated. It must notify the Superintendent or the Supervisory Body of this proposed action and publish a public notice.

3. A meeting of the members must then be called to act on the proposal. A 60-day advance notice must be sent to all members.
 - a. Approval of the recommendation requires either a two-thirds vote of the members present at the meeting or a simple majority of all members voting by mail ballot.
 - b. If liquidation is approved, a Liquidating Committee of three persons shall be appointed by the members to wind up the affairs of the credit union. With the approval of the Superintendent or Supervisory Body, the association of credit unions may be designated as the Liquidating Committee.
 - c. Within ten days, the board of directors must notify the Superintendent or Supervisory Body of the action taken by the members with respect to liquidation.
4. When the board of directors submits the question of liquidation to the membership, normal business of the credit union must be restricted or suspended relative to payments, withdrawals and transfers of shares and deposits, and granting of new loans. On approval of liquidation by the members, all such transactions are to be permanently discontinued.
5. A liquidating credit union shall continue in existence in order to discharge its debts, pay operating expenses, collect money owed to it, distribute its assets and perform all acts required to wind up its business affairs.
6. The Liquidating Committee shall distribute the assets of the credit union or the proceeds from any disposition of any such assets in the following order or sequence:
 - a. First - Secured creditors up to the value of their collateral;
 - b. Second - Costs and expenses incidental to liquidating the credit union;
 - c. Third - Wages due to employees of the credit union; and
 - d. Fourth - Owners of deposit accounts.
 - e. Fifth - General creditors and secured creditors to the extent their claims exceed the value of their collateral.
 - f. Sixth - Holders of subordinated debt.
 - g. Seventh - Holders of preferred shares, up to par value.
7. Assets then remaining shall be distributed *pro rata* to the holders of the credit union's ownership shares based on the members' share holdings.
8. When the Liquidating Committee determines that all assets from which there are reasonable expectations of realization have been liquidated and distributed, the Committee shall execute a certificate of liquidation and file the certificate, along with all books and records of the credit union, with the Superintendent or Supervisory Body. Upon their receipt, the Superintendent or Supervisory Body shall declare the credit union dissolved.

Commentary:

This is a detailed statutory procedure for voluntary liquidation of a credit union. Some countries offer only minimal detail in the Credit Union Act, referencing instead the winding up provisions of a general law such as the Companies Code or the Commercial Code.

The key requirements here are:

1. *Recommended action by the board;*
2. *Notice to the members and government supervisor;*
3. *Suspension of savings transactions and new loans;*
4. *Approval by the membership (a majority of all members if in writing or a two-thirds vote of those present at a*

meeting);

5. *Winding up the business affairs;*
6. *Distribution of assets according to the priority of claims against the credit union, with ultimate distribution of any remaining proceeds to another cooperative organization; and*
7. *Final declaration of dissolution.*

In some situations, it may be desirable to use the administrative services of the association of credit unions to wind up the business affairs of a defunct credit union. The priority of creditors in the final distribution of assets may be governed by the country's Bankruptcy Code or some law other than the Credit Union Act. Taxes owed the government will most certainly be included.

13.20 Conversion to a Credit Union

Purpose:

To allow conversion of an entity from licensing under another law to license under the Credit Union Act.

Content:

1. An entity registered under another law of this jurisdiction, such as *[specify, for example, the Cooperative Societies Act or the Companies Code]*, may be converted to a credit union registered under this Act, according to regulations issued by the Superintendent or Supervisory Body. In becoming a credit union an organization must comply with the requirements to incorporate as a credit union, including its capital and liquidity, and must have the approval of the deposit guarantee system. The entity making this application must comply with both the regulations and with the policies of the superintendent.
2. An entity registered under the laws of another type of body corporate or jurisdiction may convert to a credit union registered under this Act. To effect such a conversion, an entity must comply with all requirements of the jurisdiction under which it is currently registered and with the requirements of the Superintendent or Supervisory Body of this jurisdiction for being a credit union.
3. A credit union registered under this Act may be converted to a credit union registered under the laws of another jurisdiction, subject to regulations and approval of the Superintendent or Supervisory Body and by complying with all requirements of the jurisdiction to which it proposes to convert.

Commentary:

Many laws grant credit unions the right to convert from licensing in their jurisdiction to that of another jurisdiction. The existence of a reciprocal conversion provision in the law of the other jurisdiction is generally required.

Conversion is used when a credit union moves to another jurisdiction due to the relocation of its sponsoring organization or membership base. In a federal system, with state or provincial components, this may occur with some frequency.

Subsection 1 is an optional provision. If a Credit Union Act is being enacted for the first time, it is necessary to make provisions for any credit unions previously organized under some other law, such as a Cooperative Societies Act. Conversion is one way to do this. Another approach would be to declare that all credit unions which, prior to the enactment of this Act, were registered under any other law are now deemed to be registered under the new Credit Union Act. See Section 1.20, Alternate B. This section is also meant to allow a bank, microfinance institution or other type of cooperative to convert into a credit union.

13.25 Conversion from a Credit Union

Purpose:

To allow a credit union to convert to licensing under the Companies or Banking Act.

Content:

1. A credit union may be converted voluntarily to a company registered under the Companies Act, according to reg-

ulations issued by the Superintendent or Supervisory Body or by following the procedure laid out in this section.

2. The board of directors must first adopt a resolution in the best interest of the members recommending to the members that the credit union be converted to a company for the reasons indicated. A notice must be produced and circulated which discloses:
 - a. Any economic benefit received by directors, senior management or other officials upon conversion or any subsequent conversion;
 - b. The effect of the conversion on members' voting rights;
 - c. The rationale supporting the conversion; and
 - d. How any subsequent conversion may affect members' ownership interests.
3. The Superintendent or the Supervisory Body should be informed of the proposed action and provided with a copy of the published disclosure notice.
4. A meeting of the members must then be called to provide information and an opportunity to discuss the proposed resolution. At least 60 days advance notice of the meeting shall be given.
5. This notice shall be sent to the last known address of each member. Failure to receive notice shall not invalidate the proceedings of the meeting.
6. If there is a desire to proceed:
 - a. To participate in the meetings and vote, a member is required to have been a member of the credit union for at least one year at the time of the vote.
 - b. A second meeting shall be held not sooner than 14 days or more than 30 days after the initial meeting to discuss conversion to vote on the resolution on conversion. To be a valid vote, 30% of the total membership is required to take part in the democratic proceedings. Acceptable votes shall include postal votes, online voting and any other form permitted by the credit union. Proxy voting shall not be permitted.
 - c. Approval of the recommendation requires a vote in favor from at least 75% of the votes received.
 - d. All members must be informed of the vote.
7. Notice of the conversion must be provided to the Superintendent or the Supervisory Body in the prescribed form.
8. Licensing at the Registrar of Companies shall take place simultaneously with the de-licensing of the credit union.
9. Neither prior to conversion nor upon conversion may any net capital above the regulatory minimum may be distributed to existing members, board or management of the new entity.
10. Throughout the conversion process, no member, director or employee shall be given an opportunity to benefit in a disproportionate way relative to other members.

Commentary:

This is a detailed statutory procedure for conversion of a credit union. The key requirements here are:

1. *Recommended action by the board;*
2. *Detailed disclosure and notice to members and government supervisor;*
3. *Substantive democratic participation requiring at least 30% of the membership to partake in the democratic decision and for 75% of them to vote in favor of the conversion resolution.*
4. *Formal and simultaneous licensing of the conversion with the Superintendent of credit unions and registrar of companies.*

There are many advantages to be found in the not-for-profit structure of credit unions, such as: equality of ownership and focus on services over profits returned to external shareholders. However, there may be times when it is appropriate for a credit union to convert to another legal structure.

PART XIV

GENERAL PROVISIONS

This section details miscellaneous requirements and exemptions related to record keeping, criminal offenses and tax status.

14.10 Documents and Records

Purpose:

To provide for establishment of a system of record keeping.

Content:

1. A credit union shall maintain all books, records, accounting systems and procedures in an official language of the country, in accordance with a program developed by the association of credit unions and the regulations issued by the Superintendent or Supervisory Body.
2. A credit union may destroy records only in accordance with a schedule developed by the Superintendent or Supervisory Body, prescribing times for retention of specific records.
3. A photographic or electronic reproduction of any credit union record shall be admissible as evidence of transactions with the credit union.

Commentary:

The experience of the association of credit unions in working with credit unions throughout a country should be drawn upon in developing accounting system and record retention requirements. Nevertheless, it is the ultimate responsibility of the Superintendent or Supervisory Body to assure that appropriate accounting system and record retention requirements are developed and implemented.

The acceptability of photographic reproductions of official records may be dealt with in some other statute of the jurisdiction. If so, Subsection 3 would not be necessary.

14.15 False Reports

Purpose:

To provide a penalty for spreading false reports about the credit union.

Content:

1. Anyone convicted of maliciously spreading false reports about the finances or management of a credit union shall be fined according to a regulation of the Superintendent or Supervisory Body or be imprisoned for not less than [specify time], or both.

Commentary:

This penalty is to discourage malicious acts to undermine confidence in a credit union. While rarely invoked, it can be an important deterrent.

14.20 Criminal Offenses

Purpose:

To designate a number of offenses against a credit union as crimes with corresponding penalties.

Content:

1. Any credit union officer, director, committee member, employee or agent who is convicted by

[name of appropriate judicial or administrative tribunal] of willfully committing any of the following offenses may be fined a monetary sum or imprisoned as prescribed, or both:

- a. With intent to deceive, falsifies any books of account, report, statement, record or other document of a credit union: *[specify penalty]*;
 - b. Signs, issues, publishes or transmits to a government official any book of account, report, statement, record or other document which that person knows to be false: *[specify penalty]*;
 - c. With intent to deceive, knowingly obtains a forged signature to a document: *[specify penalty]*;
 - d. With intent to deceive, destroys any credit union book of account, report, statement, record, or other document: *[specify penalty]*; and
 - e. Engages in a conflict of interest prohibited by Section 5.35: *[specify penalty]*.
2. Any person or organization convicted of a violation of the provisions on the use of the name "credit union" found in Section 2.25 shall be fined or imprisoned: *[specify penalty]*.
 3. Any person found guilty of committing such offenses shall be prohibited from holding office in a credit union.

Commentary:

This is an optional section that may be adopted by a jurisdiction desiring to prescribe such penalties in the Credit Union Act rather than in the criminal code. In any event, the existing penalties for crimes against a financial institution should be reviewed to assure consistency.

14.25 Exemptions

Purpose:

To provide statutory exemptions for credit unions from certain taxes and other licensing requirements.

Content:

1. All credit unions registered under this Act shall be exempt from the *[specify: tax laws by statutory name]*.
2. No credit union registered under this Act shall be required to register or obtain an additional license to carry on the trade or business of a credit union with its members.

Commentary:

Most countries follow the practice of exempting credit unions from all taxation, except possibly taxes on real property owned. The tax immunity of credit unions is based on their being a unique form of cooperative financial institution. The principal reasons for exemption to taxation are:

1. *Credit unions are organized and operated on a not-for-profit, member-owned and -controlled cooperative basis. A complete exemption or narrow taxation assists credit unions in protecting themselves from inevitable loan losses, building strong capital reserves and protecting member savings. Allowing provisioning and capitalization to occur free of taxation ensures greater safety and soundness of the financial institution.*
2. *Credit unions most often serve working people of modest means and act as a buffer against usurious money lending practices that hinder asset accumulation. In credit unions, members receive credit at interest rates that are frequently lower than the prevailing market rates, regardless of how small the loan. In addition to providing affordable credit, credit unions foster systematic savings and help members in the management of their money. Governments that are supportive of these principles encourage the growth of credit unions through tax exemptions.*
3. *As financial institutions whose purpose is not the maximizing of its profit, credit unions are stable institutions that may experience less growth in good times but also perform better in times of stress. This stability and the competitive pressures credit unions can provide in a market place add to financial sector stability in a country. By providing credit unions an exemption of paying income taxes, policy makers are encouraging financial sector stability and plurality in the*

financial system.

4. *In instances where credit unions are taxed to some degree, net income (i.e. gross income minus dividends) , as opposed to members' dividends, should be taxed to avoid double taxation.*

INTERNATIONAL CREDIT UNION

OPERATING PRINCIPLES

These International Credit Union Operating Principles are founded in the philosophy of cooperation and its central values of equality, equity and mutual self-help. Recognizing the varied practices in the implementation of credit union philosophy around the world, at the heart of these principles is the concept of human development and the brotherhood of mankind expressed through people working together to achieve a better life for themselves and their community.

Democratic Structure

Open and Voluntary Membership

Membership in a credit union is voluntary and open to all within the accepted common bond of association that can make use of its services and are willing to accept the corresponding responsibilities.

Democratic Control

Credit union members enjoy equal rights to vote (one member, one vote) and participate in decisions affecting the credit union, without regard to the amount of savings or deposits or their volume of business. Voting in credit union support organizations or associations may be proportional or representational, in keeping with democratic principles. The credit union is autonomous, within the framework of law and regulation, recognizing the credit union as a cooperative enterprise serving and controlled by its members.

Non-Discrimination

Credit unions are non-discriminatory on all grounds, including but not limited to race, nationality, sex, religion and politics.

Service to Members

Distribution to Members

To encourage thrift through savings and thus to provide loans and other services, a fair rate of interest is paid on savings and deposits within the capability of the credit union.

The surplus arising out of the operations of the credit union after covering the cost of finance, operating costs, provisions for loan losses and ensuring appropriate capital reserve levels, belongs to and benefits all members with no member or group of members benefiting to the detriment of others. This surplus may be distributed among members in proportion to their transactions with the credit union, as dividends on shares or directed to improved or additional services required by the members.

Building Financial Stability

A prime concern of the credit union is to build the financial strength, including adequate reserves and internal controls that will ensure continued service to membership.

Service to Members

Credit union services are directed to improve the economic and social well-being of all members.

Social Goals

On-Going Education

Credit unions actively promote the education of their members, officers and employees, along with the public in general, in the economic, social, democratic and mutual self-help principles of credit unions. The promotion of thrift and the wise

use of credit, as well as education on the rights and responsibilities of members, are essential to the dual social and economic character of credit unions in serving member needs.

Cooperation Among Cooperatives

In keeping with their philosophy and the pooling practices of cooperatives, credit unions within their capability actively cooperate with other credit unions, cooperatives and their associations at local, national and international levels in order to best serve the interests of their members and their communities.

Social Responsibility

Continuing the ideals and beliefs of cooperative pioneers, credit unions seek to bring about human and social development. Their vision of social justice extends both to the individual members and to the larger community in which they work and reside. The credit union ideal is to extend service to all who need and can use it. Every person is either a member or a potential member and appropriately part of the credit union sphere of interest and concern. Decisions should be taken with full regard for the interest of the broader community within which the credit union and its members reside.

GLOSSARY

A brief explanation of terms used or referred to in the *Model Law*.

A

Accounting The recording, summarizing, reporting and interpreting of financial transactions.

Agent An individual or organization representing or acting on behalf of another person.

Amortize The provision for the repayment of a loan in periodic payments over a stated period of time.

Annual Percentage Rate (APR) The annual finance charge expressed as a percentage of all of the costs of the loan.

Appraisal An estimate of the value of property.

Appreciation An increase in the value of an asset.

Asset Something of value that can be used to repay debt.

Association of Credit Unions A grouping of credit unions established to foster their organization and development and to improve their internal operations. It may also be known as a League, Federation, Central, etc.

Attachment The seizure of property used as collateral for a loan, through legal action.

Audit An examination and verification of an organization's books and records.

Automated Teller Machine (ATM) Electronic banking equipment used to obtain financial services, usually to withdraw savings or make loans, generally activated by plastic cards, push buttons and coded numbers.

B

Balance The amount owed, unpaid or outstanding.

Balance Sheet An abbreviated list of assets and liabilities showing net worth or deficit on a given date.

Bank A financial institution where money is held for saving or commercial purposes or is invested, supplied for loans or exchanged.

Bankruptcy A court action declaring a person free of most debt, due to the inability of the person to pay.

Board of Directors Elected representatives of the members of a credit union responsible collectively for controlling its business affairs.

Budget A prediction of the financial condition of an individual or organization for a future time period.

Business loan A loan made for commercial, industrial or agricultural purposes, usually using assets of the business enterprise as collateral, such as buildings, equipment, products or inventory.

Bylaws The rules adopted by the members of a credit union and board of directors that define the field of membership, governance structure and rights and responsibilities of membership.

C

Capital Represents net worth and ownership of an enterprise. Capital can be measured by the excess of assets over liabilities.

Capital adequacy The amount of capital necessary to absorb losses while providing financial stability.

Cash Money that has immediate purchasing power such as currency and checking accounts.

Central Credit Union A credit union whose membership principally includes other credit unions, and generally provides liquidity, investment opportunities and depository facilities to members.

Central Finance Facility (CFF) An entity, usually a department of a federation, that provides financial services similar to

a central credit union.

Central Liquidity Facility An entity, usually operated by a federation or government agency, which manages liquidity for credit unions.

Charged-off loans Loans that are treated as losses for accounting purposes.

Check A written order to a financial institution to pay money from funds on deposit.

Collateral See "Security".

Co-maker A person, other than the borrower, signing a note as a form of added security to the lender; such person is liable for the loan if the borrower fails to pay within the agreed time.

Co-signer See "Co-maker".

Consumer credit A lending transaction involving an individual rather than a business and which is primarily for a personal, family or household purpose.

Cooperative society A self-help business enterprise, collectively owned and democratically controlled by its members, that provides services for its members on a not-for-profit or cost basis.

Credit (1) An accounting entry that decreases assets or increases liabilities. (2) A loan.

Credit card An instrument or device issued by a financial institution or other organization for use by the cardholder in obtaining money, goods, services or anything of value as a loan.

Credit committee A group of credit union members with the responsibility to approve or reject loan requests.

Credit life and disability insurance Insurance issued on the debt of borrowers to cover repayment of loans in case of death or disability.

Credit risk The possibility of loss to a lender resulting from non-payment by a borrower.

Credit union (1) A group of people who join together to save money and to make loans to each other. (2) A financial cooperative society organized by a group of people with a shared field of membership.

Current assets and liabilities Accounts that have maturities of one year or less.

D

Debit An accounting entry that increases assets and decreases liability accounts.

Delinquent A loan account that is past due without a satisfactory repayment arrangement.

Demand deposit These are deposits payable on demand, drawn against by a payment mechanism with no prior notice of withdrawal needed. A check or share draft is a demand deposit.

Deposit account Funds held by a financial institution, such as a credit union or a bank, on behalf of another person, sometimes designated as a savings account, deposit certificate, checking account or demand deposit.

Deposit insurance A program that guarantees the funds of depositors in a financial institution against loss in the event that the institution fails.

Depreciation The decrease in value of an asset over a period of time.

Differential interest rate This rate may be established for different classes of loans according to type, purpose, amount, quality and type of guarantee or any combination of these factors.

Dividend A share of earnings distributed to the members of the credit union, recorded as a percentage.

E

Earnings Income produced as a profit or return, such as wages for work, profits from business operations or yield on investments.

Equity Represents what members own and is measured by the excess of assets over the liabilities. Equity represents the members' and credit union's net worth. This includes member capital shares, reserves and undivided earnings. Also known as capital.

Equity capital This is the capital that an individual or institution own in an enterprise; also known as institutional capital in credit unions.

Examination An inspection of a financial institution, often by a government agent, to determine the institution's solvency and compliance with laws and regulations and to give advice or direction on operational matters.

Expenses Payments made for the costs of operations. They include salaries, transportation, office supplies, rent, interest and, in some countries, dividends on member savings.

F

Fidelity bond A type of insurance that protects an organization against fraud or other dishonest acts of its employees.

Finance charge The interest cost and fees of a loan.

Financial institution An enterprise specializing in the handling and investment of funds, such as a bank, building society, trust company or credit union.

Fiscal agent A person or organization serving as another's financial representative.

Fixed assets Non-income-earning assets, including land, buildings, furniture and equipment.

Fixed-interest rate An interest rate that stays the same throughout the life of a loan.

G

Governmental body Any department, agency, authority, instrumentality or other unit or organization of a national, federal, provincial, state, county, municipal or other level of government.

Grace period Prescribed period after payment due date during which no late penalty is assessed.

Guaranteed loan A loan made by a financial institution in which payment of the principal, interest or both is guaranteed by another organization, sometimes a government body.

I

Illiquid When a financial organization is unable to meet demand for funds.

Income An amount of gain or benefit in return for an investment of labor or resources.

Inflation A rise in prices resulting in a decrease in the value of money.

Insolvency The inability of an individual or organization to repay all obligations.

Institutional capital In credit unions, capital reserves, accumulated surplus (retained) earnings, donations and other net-worth accounts owned collectively by all members.

Interest The price paid for the use of money, such as for a loan or a deposit, recorded as a percentage.

Interest rate The rate charged for a loan or paid for a deposit, recorded as a percentage.

Interlending This is the practice of lending between credit unions within a country.

Investments Any funds that are placed into financial instruments for the purpose of producing income or a profit. For example, securities such as bonds, notes, and certificates of deposit purchased by a credit union to obtain a yield on funds not lent to members. Also may include shares or stock of credit union service organizations, central credit unions, cooperatives and other enterprises.

Investment portfolio The total number of investments that an individual or organization maintains.

Investment yield The rate of profit earned on an investment.

J

Jurisdiction The territory over which governmental authority extends such as a country, province, or state.

L

League See "Association of Credit Unions".

Liability A legal obligation to repay a debt.

Liability insurance Protects against legal action brought against an individual or organization.

Line of credit A pre-approved cash amount that a lender is making available to the borrower, usually distributed and repaid at irregular intervals.

Liquidation The process of converting assets into cash. Frequently means using these proceeds for discharging debts in terminating the affairs of a business or credit union.

Liquidity Ability to meet demand for funds.

Loan application A form requiring information used to determine whether a borrower is granted a loan.

Loan charges Costs incidental to making a loan passed on to the borrower, such as for public filing fees, title searches, credit reports and legal fees.

Loan contract A legally binding agreement between two or more parties that details the terms and conditions of a loan. An instrument evidencing a debt. It may be payable on demand, in installments, or at a fixed maturity rate. A promissory note is a common loan contract.

Loan delinquency When an individual or organization fails to meet debt obligations as scheduled in a loan contract.

Loan extension An agreement with the lender to allow the borrower to make smaller payments on an outstanding debt over a longer period of time.

Loan loss allowance Funds set aside from operating income of the credit union to cover the probable loss on various classes of delinquent loans.

Loan refinancing An agreement to revise the existing debt by incurring a new debt that incorporates or pays off the existing debt.

Loan yield The interest rate earned on a loan.

Long-term investments Investments that mature after more than 12 months.

M

Market interest rates A composite of the interest rates financial institutions, governments and other organizations are paying for funds and what they are charging for financial instruments such as loans.

Market value The highest price that property or an asset will bring in a competitive and open market.

Maturity The date when a loan or financial instrument is due and payable.

Merger The combining of two or more organizations by transferring their assets and liabilities to one surviving organization.

Minor A person who has not reached the age at which the law recognizes a capacity to make contracts.

N

Net income Difference between total expense and total income.

Notes payable Represents what the organization has borrowed.

O

Organization Any corporation, association, partnership, society, firm, syndicate, trust or other legal entity.

Ownership share means a balance held by a credit union and established by a member, which represents the member's ownership interest in the assets of the credit union.

P

Par value The standard worth or face value of a security, such as a credit union share.

Participation loan A loan made by more than one financial institution and serviced by one of the institutions.

Pension plan A program established, generally by an employer, to pay a sum of money regularly to a person who has retired from active employment.

Person Any natural person, organization or governmental unit.

Policy A statement of an organization's purpose that guides individual and group actions.

Principal The original amount of a loan before interest or other charges are levied.

Promissory note Instrument evidencing a debt. It may be payable on demand, in installments or at a set maturity.

Q

Quorum The minimum number of members of a constituted body needed for the valid transaction of business.

R

Regulation A rule or order issued by a governmental agency having the force of law.

Reserves General (or statutory) reserves are formed from retained earnings and maintained by a credit union as required by law. Liquidity reserves are funds held by an institution to guarantee the availability of funds to meet expected claims.

Retirement plan See "Pension plan."

Risk assets Certain loans, investments and other property of the credit union for which some possibility of loss exists. Risk assets, as defined by law or regulation, are often used to determine the amount of credit union income to be transferred to the general reserve.

Risk Weighted Capital Ratio Consists of a numerator that represents the amount of capital in a financial institution and a denominator that represents the asset classes, by risks that a financial institution holds.

Risk management The process of protecting an organization's assets and resources from loss.

S

Safety In an investment sense, the degree of protection against potential loss.

Savings and Loan Association See "Building and Loan Association."

Scale-down An official reduction in the par value of a credit union share in order to restore the solvency of the credit union.

Security Something of value pledged to ensure the repayment of a loan and subject to seizure upon default. Also known as collateral.

Share An amount that must be invested in a credit union by a member, representing the member's ownership interest in the assets of the credit union; a portion of the credit union's capital.

Short-term investment Those investments that mature in one year or less.

Simple interest rate Interest is paid only on the unpaid balance, so that borrowers pay only for the time they actually have use of the funds.

Solvency The ability to repay all debts.

Sources of funds Funds received or generated by a financial institution including savings, loans and capital.

Stabilization Fund A program to provide technical aid and advice and limited financial assistance to credit unions that are insolvent or experiencing problems that may lead to insolvency.

Subordinated Debt Debt that is either unsecured or has a lower priority than that of another debt claim on the same asset or property.

Supervisory Agency A governmental, private or mixed body responsible for chartering, overseeing and regulating credit unions.

T

Technical insolvency Inability of a credit union or other financial institution to repay all debts, deposits and loan obligations to members, owners or customers if it were to be liquidated. The institution may be liquid or illiquid.

Trustee A person or agent to whom the property or funds of another person (beneficiary) are legally entrusted for administration.

U

Undivided earnings The total accumulated profits or earnings of a credit union that are retained as a capital account item.

Unimpaired capital Invested capital that is worth the full amount of the original investment.

V

Variable or floating interest rate An interest rate that may be changed during the life of the loan due to changes in the cost of capital, financial market conditions or bank rates.

Variable-rate loan A type of loan whose interest rate can be adjusted to changes in market rates.

Volunteer A person who works on behalf of a credit union as a committee member or director without wage payments.

W

Wage assignment An agreement permitting a lender to collect a certain portion of a borrower's wages from the borrower's employer if payment on the loan is not made as agreed.

Write-off The financial recognition of problematic loans no longer being an asset of the institution.

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