REGULAR STATE CREDIT UNION BOARD MEETING
HELD BY CONFERENCE CALL
OFFICE OF THE COMMISSIONER
DEPARTMENT OF FINANCIAL INSTITUTIONS
2000 SCHAFER STREET, SUITE G
BISMARCK, NORTH DAKOTA

March 16, 2012

The regular meeting of the State Credit Union Board was called to order by Chairman Entringer in the Office of the Commissioner, Department of Financial Institutions, 2000 Schafer Street, Suite G, Bismarck, North Dakota, at 9:38 a.m., Friday, March 16, 2012.

MEMBERS PRESENT: Robert J. Entringer, Chairman *(Office)*
Paul Brucker, Member *(Office)*
Melanie Stillwell, Member *(Williston)*
Darlene Watne, Member *(Minot)*

MEMBER ABSENT: Steve Tonneson, Member

ALSO PRESENT: Aaron Webb, Secretary *(Office)*
Suzette Richardson, Administrative Staff Officer *(Office)*
Janilyn Murtha, Assistant Attorney General *(Office)*
Corey Krebs, Chief Examiner – Credit Unions *(Office)*
Greg Tschider *(Office)*
Jeff Olson, CU Association of the Dakotas *(Office)*

APPROVAL OF MINUTES

Chairman Entringer indicated the Board received copies of the minutes of the regular meeting held on December 2, 2011.

It was moved by Member Watne, seconded by Member Brucker, and unanimously carried, with Member Tonneson absent, to approve the minutes of December 2, 2011, as presented.

DAKOTA WEST CREDIT UNION, WATFORD CITY – STANLEY BRANCH

Chairman Entringer indicated the Department received notification from Dakota West Credit Union, Watford City, that its branch in Stanley opened for business December 15, 2011; however, the Board's Order gave the credit union until December 3, 2011, to commence business in Stanley, unless this date was extended or modified by the Board. Chairman Entringer indicated the delay resulted from the contractor encountering issues related to the flooding.

Chairman Entringer indicated he sent a letter to CEO Zubke acknowledging the date the branch was opened and also that the Board would be advised of the delayed opening at this meeting.

DRAFT OF PROPOSED ADMINISTRATIVE RULE AMENDMENTS

Chairman Entringer noted that a draft of the proposed administrative rule amendments was previously mailed to the Board on February 24, 2012. Chairman Entringer indicated Department staff have met with Greg Tschider and Jeff Olson to discuss the proposed amendments.

Chief Examiner Krebs reviewed each proposed amendment to the administrative rules with the Board. Chief Examiner Krebs indicated there are several terminology changes, as well as changes reflecting expired or no longer applicable items.

Section 13-03-01.1-02: correspondence and filings may be submitted in electronic format.

Section 13-03-02-02: remove reference to corporate central credit union.

Section 13-03-02-02(3): brings appraisal regulation in line with federal regulation and FFIEC guidance.

Section 13-03-02-02(4): eliminates instances of forced insurance.

Section 13-03-02-02(6): eliminated entirely – outdated and no longer an industry practice.

Section 13-03-02-04: eliminated entirely – redundant as this is referenced in the North Dakota Century Code.

Section 13-03-02-07: updated the capital measurement to most widely used definition in order to be consistent with other regulations.

Section 13-03-03-01: remove reference to corporate central credit union, and makes clear this is aggregate, thus eliminating the doubling down on losses; also establishes a waiver process and makes clear that all investment must be consolidated together in determining limit.

Section 13-03-04-01: remove reference to corporate central credit union.

Section 13-03-05-04: splits criteria into those for normal merger and those for a merger of a failing credit union; gives State Credit Union Board more flexibility to handle problem credit unions and makes clear the criteria for friendly mergers of sound credit unions.

Section 13-03-06-01: defines net worth and components of net worth, consistent with federal definitions.

13-03-08-03: establishes rules for overdrafts mostly consistent with federal rules; also the accounting and reporting treatment for overdrafts is made more clear and is consistent with the current standards to which credit unions are held.

13-03-15-04: wording corrected for more supportable measurement criteria.

13-03-15-06: new Section added to improve communication between credit union, membership, and the Department.

13-03-16-01: definitions changed to be in line with federal definitions.

13-03-16-02: changes reflect consistency with federal rules; expands exemptions from personal guarantees and establishes a waiver.

13-03-16-03: removes confusing language, and removes monitoring requirements that duplicate information already received by the Department through the call reporting policies.

13-03-16-04: Section amended in order to be consistent with industry standards and guidance.

13-03-16-05: brings exclusions in line with federal exclusions.

> Chairman Entringer explained this change indicates a credit union has to have a commitment to buy a single-family residence and also get to exclude one single-family residence that is being constructed.

13-03-16-06: amended to be consistent with federal rules.

13-03-16-08: makes reader aware of the waiver process elsewhere in the North Dakota Century Code; deleted section is now covered in the definition of a member business loan; added an exception under the aggregate loan limit.

13-03-20-01: adds Farm Credit Services to the list of financial organizations for purposes of participation loan chapter.

13-03-20-02: allows participation loan to be acted on by the loan committee or credit manager, in addition to other named parties.

13-03-21-02: addresses the fact that pooling is no longer exclusive industry practice; brings code in line with current secondary market practice; allows loan committee or credit manager to partake in decisions.

13-03-23-02: replaces definition of “equity” with “net worth”.

13-03-23-03: gives the commissioner authority to approve investments, instead of the State Credit Union Board, to speed up approval process.

13-03-23-05: better organizes CUSO activities making them more consistent with federal activities, also adds appraisal services; creates

notification requirement for any change in operations by CUSO; gives State Credit Union Board exclusive authority to approve or disapprove additional activities not expressly authorized under rule; makes clear the ability to limit activity based on safety and soundness.

Chairman Entringer pointed the major change is that "subject to approval by NCUA" is eliminated; further explaining if the Department is adding a service requested by a credit union, it does not have to be presented to NCUA for approval.

Member Watne referred to real estate brokerage services, and Chairman Entringer indicated that service was previously listed; however, a credit union had to receive approval from the State Credit Union Board in order to offer the service.

13-03-23-06: makes title more reflective of section content; updated wording to "net worth"; changed approval process to a notification requirement.

13-03-23-08: provides that a credit union must include within its written agreement with CUSO various provisions designed to ensure compliance with state and federal law.

Member Brucker asked for clarification regarding Section 13-03-03-01. Chief Examiner Krebs explained the Section currently reads that a credit union shall invest no more than 10% in aggregate of the total paid in shares and deposits. Chief Examiner Krebs explained the change is trying to define the 10%, whether it is 10% of a credit union's paid-in shares and deposits after losses, or before. For example, if a credit union invests $1 million, which is 10% of its paid-in shares and investments, and loses $500,000, does the credit union then have the capacity to invest an additional $500,000? Chief Examiner Krebs indicated the object is to eliminate the practice of doubling down on losses, and eliminate instances in which market losses result in the ability to engage in more of the same activity. The major point is to eliminate risk to any one time of investment.

Mr. Tschider indicated it is his opinion the word "invest" means how much has been purchased; what was the actual cost basis. Mr. Tschider continued this does not refer to the fair market value at that particular time, but the investment or how much cash has been used.

Assistant Commissioner Webb explained that if there are multiple investments the aggregate of 10% of all investments may not exceed 10%, instead of a 10% cap on each investment.

Member Brucker referred to Section 13-03-16-02(2) and (3) regarding liens and asked if this relates to member business loans only, and does not include other real estate loans. Chief Examiner Krebs indicated the entire Section refers to member business loans only.

Chief Examiner Krebs indicated due to the Glen Ullin Credit Union embezzlement, the Department is questioning whether or not the current audit requirements are sound. Chief Examiner Krebs explained the North Dakota Administrative Code requires a financial institution that is greater than $25 million in assets must have a CPA opinion audit; however, a credit union below $25 million in assets can rely on a supervisory committee audit. Chief Examiner Krebs indicated the Department is questioning if this is an adequate safeguard, and due to the proposed changes to the North Dakota Administrative Code discussed today, whether this would be an appropriate time to address what an adequate audit requirement is for those credit unions below $25 million in assets. Chief Examiner Krebs indicated currently there are ten credit unions that have less than $25 million in assets; however, only two of those do not currently get CPA opinion audits.

Mr. Tschider indicated he recalls only two credit union embezzlements of any significance: Linton Credit Union and Glen Ullin Credit Union. Mr. Tschider indicated that Linton Credit Union had a CPA audit; however, the embezzlement was not discovered. Mr. Tschider stated he is not convinced a CPA audit at the Glen Ullin Credit Union would have discovered the embezzlement since the manager was maintaining two sets of books. Mr. Tschider stated that CPAs cannot find everything and that a good embezzler can get around the audit.

Mr. Tschider stated he favors CPA audits in that a third party is brought in to review records, and that he also believes the credit unions should make sure the CPA firm has good malpractice insurance.

Mr. Tschider stated he believes it is a question of whether requiring CPA audits would be a financial burden to the smaller credit unions and impact their survival.

Member Watne stated the credit unions are handling people's money; therefore, she feels annual CPA audits should be required. Member Watne stated

she assumed all credit unions were being audited annually by a CPA firm, and added she feels the protection of an audit by a CPA firm that has malpractice insurance is necessary.

Member Watne asked Mr. Tschider how the embezzlement would have been handled if Glen Ullin Credit Union would have had a CPA audit. Mr. Tschider explained CPA auditors are responsible for following generally-accepted audit principles, which includes confirmation of account balances. Mr. Tschider stated he does not know if there was ever any confirmation on account balances at Glen Ullin Credit Union; however, if done, the embezzlement may have been discovered. Mr. Tschider added that in the case of Linton Credit Union, many confirmations of account balances had been done; however, the manager was able to conceal the embezzlement for many years. Mr. Tschider stated CPA audits are not a 100% guarantee.

Chairman Entringer indicated he asked a regional accounting firm if they do verify deposit balances, and the answer was yes, but it is a negative verification on a 100% of the deposits; typically the CPA firm asks the credit union to put on the bottom of the statement sent out to members the comment "please verify that this is accurate and respond back if it is not". Chairman Entringer indicated in the case of Glen Ullin Credit Union, it is very unlikely the embezzlement would have been discovered since the manager was using two sets of books.

Member Stillwell added that the Glen Ullin Credit Union only switched to a computer system two years ago; therefore, the manager would have given a CPA the manual records that were provided to the members, which contained balances the members thought they had; however, the second set of books showed what the members' balances actually were. Member Stillwell stated even after the computer systems was in place, she does not believe a CPA audit would have discovered the embezzlement.

Chief Examiner Krebs reiterated the question is whether the Department needs to establish better controls to help prevent future embezzlements.

Member Brucker questioned if this is a matter that can be effectively dealt with through the examination process and, if not, perhaps rule changes are necessary.

Member Brucker added the credit unions under $25 million in assets are required to have a supervisory committee audit, which is an internal group of volunteers of the credit union that are supposed to be qualified to review the books.

Chairman Entringer indicated that every other year a part of the supervisory committee audit must be a verification of account balances.

Chief Examiner Krebs indicated during an examination the examiners will evaluate more closely the supervisory committee audits.

Chairman Entringer stated he believes an employee of a financial institution understands the process and, therefore, can figure out how to get around the internal controls.

Chairman Entringer stated this is an area Department staff wanted to discuss with the Board, and concluded it will be dealt with through the examination process.

Chairman Entringer explained the process for the administrative rules, indicating if proposed amendments are approved by the Board, the proposed amendments will be published; a hearing date will be set which allows additional comments to be presented within 10 days from the date of the hearing; the Board will have the opportunity to make any non-substantive changes, as well as considering any comments that were presented; the proposed amendments would then be sent to the Attorney General's Office for review; when confirmed by the Attorney General's Office the proposed amendments will be sent to the Legislative Council; a hearing is then scheduled before the Administrative Rules Committee at which time changes can be made; finally, when approved, an effective date for the changes is set.

It was moved by Member Brucker, seconded by Member Watne, and carried by a vote of 4 to 0, with Member Tonneson absent, to approve the draft of proposed administrative rule amendments, subject to technical changes by Assistant Attorney General Murtha.

CREDIT UNION BUDGET UPDATE

Chairman Entringer reviewed the Organizational Status by Summary Account and Source for credit unions for the month ending January 31, 2012, as presented.

DEPARTMENT PUBLIC INFORMATION OFFICER

Chairman Entringer indicated that he is the public information officer for the Department. Chairman Entringer explained due to the embezzlement at Glen Ullin Credit Union his request is that if any of the Board members are contacted by a reporter regarding an issue the Department or Board are engaged in, that the calls be referred to him. However, Chairman Entringer noted that each Board member did have the right to talk to the press.

GLEN ULLIN CREDIT UNION UPDATE

Mr. Tschider informed the Board that the FBI has been investigating the Glen Ullin Credit Union embezzlement and it appears they will file a formal criminal charge against the credit union manager. Mr. Tschider indicated it appears payment will be made no later than mid-April 2012, adding that no credit union members will lose any money.

Mr. Tschider and Mr. Olson left the meeting at 10:40 a.m.

SPECIAL MEETING

Chairman Entringer informed the Board a special meeting will be held on Tuesday, April 24, 2012, at 9:30 a.m., by conference call, to review the request by Noridian Employees Credit Union, Fargo, to expand its field of membership. Chairman Entringer indicated an application to merge Noridian Employees Credit Union, Fargo, into Capital Credit Union, Bismarck, should be received to be considered by the Board in June 2012. Chairman Entringer indicated the regularly scheduled June 1, 2012, meeting may be rescheduled for later in June.

STAFF REQUEST

Member Brucker respectfully requested that the Department staff consider sending a letter to the credit unions currently not being audited by an outside CPA firm informing them that the Board is recommending in order to protect their members that they consider getting a CPA audit, due to the present embezzlement in

the Glen Ullin Credit Union. Chairman Entringer indicated the Department will contact those credit unions.

The Board went into closed session at 10:40 a.m. to review the Supervisory Reports of Examination pursuant to North Dakota Century Code 6-01-07.1.

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Robert J. Entringer, Chairman	Aaron K. Webb, Secretary