

## F I N A L R E P O R T

### CREDIT UNION SHARE DRAFTS JOINT SUBCOMMITTEE OF THE SENATE AND HOUSE STANDING COMMITTEES ON COMMERCE

December, 1978

This Joint Subcommittee was created as required by Acts of the Sixty-seventh General Assembly, 1978 Session, Chapter 1190, section 24, for the purpose "of determining the need for legislation relating to share drafts of credit unions." Three meetings were authorized and three meetings were held.

The membership of this Subcommittee is as follows:

Senator Cloyd Robinson, Co-chairperson  
Representative Arthur A. Small, Jr., Co-chairperson  
Senator William D. Palmer  
Senator Irvin L. Bergman  
Representative Ned F. Chiodo  
Representative Cooper Evans

The term "share draft" is used to identify a written order which is issued by a credit union member and which directs the credit union to pay the amount designated in the order to the person named in the order out of funds held by the credit union in an account of the issuing member. The function of a share draft is to enable a credit union member to disburse his or her credit union account funds in the same manner as a person disburses funds from a bank checking account.

This Subcommittee attempted to determine how share drafts are dealt with in the laws of other states. Information received by this Subcommittee indicates that few states have enacted specific share draft legislation. In many states, the authority to provide share draft services is believed to exist either as a result of the use of share drafts by federal credit union members, or as an implied or incidental power of a credit union under applicable state law. Of the forty-six states having state-chartered credit unions, share drafts were actually in use in 34 states as of October 16, 1978, according to a representative of the Credit Union National Association, Inc.

This Subcommittee received written and oral comments regarding share drafts and share draft legislation from representatives of the Iowa Department of Banking, the Iowa Credit Union League, the Iowa Bankers Association, the Iowa Independent Bankers, and Iowa-chartered credit unions and credit union members. There is no consensus of opinion either on the need for credit union share drafts or on the type of permanent legislation which is appropriate in the event share drafts are to be legalized in Iowa. Members of those Iowa credit unions which presently offer share draft services under the temporary authority enacted during the

1978 Session have indicated that credit unions should be allowed to provide share draft services in the future. Federal credit unions doing business in Iowa presently offer share draft services to their members, and it appears that they are unaffected by state share draft legislation.

This Subcommittee recommends that permanent authority be enacted to enable state-chartered credit unions to offer share draft services to their members, and submits the attached bill draft, LSB 379S-H, with the recommendation that it do pass.

HOUSE FILE \_\_\_\_\_

By PROPOSED COMMERCE  
COMMITTEE BILL by Credit  
Union Share Drafts Subcommittee

Passed House, Date \_\_\_\_\_ Passed Senate, Date \_\_\_\_\_

Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_ Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_

Approved \_\_\_\_\_

## A BILL FOR

1 An Act relating to drafts drawn upon credit unions.

2 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

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1 Section 1. Chapter five hundred thirty-three (533), Code  
2 1979, is amended by adding the following new section:

3 NEW SECTION. SHARE DRAFTS.

4 1. As used in this section, unless the context otherwise  
5 requires:

6 a. "Share draft" means a negotiable or nonnegotiable draft  
7 used to withdraw shares from a share draft account.

8 b. "Payable-through bank" means the bank which is  
9 designated to make presentment of a share draft to the credit  
10 union for payment.

11 c. "Truncation" means the original share draft is not  
12 returned to the member.

13 d. "Share draft account" means a regular share account  
14 from which the credit union has agreed that shares may be  
15 withdrawn by means of a share draft.

16 e. "Liquidity reserve" means an allocation of cash, demand  
17 deposits in state and national banks, and instruments of the  
18 United States treasury required of a credit union engaged  
19 in a share draft program, to be used to ensure that share  
20 drafts are honored promptly.

21 2. Subject to the provisions of this section, a credit  
22 union may provide its members with share drafts. The board  
23 of directors shall determine, prior to requesting approval  
24 to implement the share draft program, that the members' use  
25 of share drafts is economically and operationally feasible  
26 for the credit union.

27 3. The share accounts and deposit accounts of a credit  
28 union operating a share draft program must be insured by the  
29 national credit union administrator. An uninsured credit  
30 union operating a share draft program on the effective date  
31 of this Act shall not expand the program until its accounts  
32 are so insured, and the credit union shall obtain account  
33 insurance within twelve months after the effective date of  
34 this Act. The administrator shall terminate the share draft  
35 program of any credit union which does not comply with this

1 provision. The provisions of this subsection supersede the  
2 provisions of section five hundred thirty-three point sixty-  
3 four (533.64) of the Code with respect to credit unions  
4 operating share draft programs.

5 4. A credit union shall submit to the administrator a  
6 written request to operate a share draft program. The request  
7 shall include all of the following:

8 a. A certified copy of the minutes of the board of  
9 directors authorizing a request to the administrator for  
10 approval to implement the share draft program.

11 b. All background documentation which supports the board  
12 of directors' decision that the members' use of share drafts  
13 is economically and operationally feasible for the credit  
14 union.

15 c. A statement verified by legal counsel that the forms  
16 and procedures to be used have been reviewed by legal counsel.

17 d. A statement verified by the chairperson of the board  
18 of directors that the board of directors has determined  
19 appropriate surety bond coverage is in force.

20 e. A statement of operational specifications and procedures  
21 which expressly provides for all of the following:

22 (1) Identification of the payable-through bank.

23 (2) Truncation.

24 (3) A share draft account agreement with each participating  
25 member which outlines the responsibilities of the credit union  
26 and the member.

27 (4) The recording of overdrafts and notification to an  
28 overdrawn member.

29 (5) The encoding of each share draft with the routing  
30 and transit number of the payable-through bank, the share  
31 draft account number, and the serial number of the share draft  
32 in accordance with standards required for use in a clearing  
33 system utilizing magnetic ink character recognition devices.

34 (6) The preprinting on the share draft of the names of  
35 the payable-through bank and the credit union.

1 (7) A method by which each member using share drafts may  
2 maintain a record of share drafts drawn.

3 (8) The submission of a periodic statement of account  
4 at least quarterly to each member who has a share draft  
5 account, which shall include for each share draft processed  
6 the serial number, the date of payment and the amount of  
7 payment.

8 (9) Establishing responsibility for detection of  
9 unauthorized or forged drafts.

10 (10) Procedures for processing stop payment orders.

11 (11) Procedures for providing members with copies of paid  
12 drafts should copies be requested.

13 (12) Procedures for retaining paid drafts or copies of  
14 paid drafts on file for a period of five years.

15 (13) The fees, if any, to be charged for share draft  
16 account services. The fees shall not exceed the direct and  
17 indirect costs of providing the services.

18 (14) Procedures for establishing, maintaining, verifying  
19 and replenishing as necessary each business day a minimum  
20 liquidity reserve consisting of cash in the credit union plus  
21 demand deposits in state or national banks in an amount equal  
22 to three percent of all shares and deposits upon which share  
23 drafts can be written, plus United States treasury instruments  
24 owned by the credit union in an amount equal to ten percent  
25 of these shares and deposits.

26 5. A credit union shall not commence the operation of  
27 a share draft program until it has received written approval  
28 from the administrator. The administrator may limit member  
29 participation for a period not to exceed one year. The  
30 administrator shall not give approval if any of the following  
31 conditions exist:

32 a. The requirements of subsection three (3) of this section  
33 have not been met.

34 b. The auditing committee has not fulfilled its statutory  
35 duties as specified in this chapter.

1 c. The management of the credit union has demonstrated  
2 through prior performance its inability to handle the  
3 additional activity the share draft program will generate.

4 d. The credit union is not insured by the national credit  
5 union administrator.

6 6. a. The credit union shall notify the administrator  
7 in writing at least sixty days in advance of the proposed  
8 implementation date of a modification relating to any of the  
9 following:

10 (1) The payable-through bank.

11 (2) Truncation procedures.

12 (3) The share draft agreement.

13 (4) Procedures for establishing and maintaining the  
14 liquidity reserve.

15 (5) Any material modification of the share draft program  
16 not previously reviewed and approved by the administrator.

17 b. A modification referred to in paragraph a of this  
18 subsection shall not be made except upon written approval  
19 of the administrator.

20 c. The credit union shall immediately notify the  
21 administrator of any matter affecting the information provided  
22 pursuant to paragraphs a through d of subsection three (3)  
23 of this section.

24 7. If a share draft program or a request for modification  
25 is not approved, or if a share draft program is approved for  
26 limited member participation, the administrator shall provide  
27 to the credit union a written statement of the reasons for  
28 the action.

29 8. A credit union shall not waive the right to require  
30 notice as set forth in the bylaws, but may guarantee payment  
31 of a share draft if both of the following conditions are met:

32 a. A specific guarantee authorization is obtained for  
33 the share draft from the credit union.

34 b. The guarantee authorization is immediately noted on  
35 the share draft account to prevent the withdrawal of shares

1 needed to pay the guaranteed share draft.

2 Sec. 2. Chapter five hundred thirty-three (533), Code  
3 1979, is amended by adding the following new section:

4 NEW SECTION. PAYMENT OF SHARE DRAFTS DURING DISSOLUTION.

5 Other provisions of the Code notwithstanding, when a credit  
6 union is dissolved, first priority of payment shall be given  
7 to unpaid share drafts. However, a share draft shall not  
8 be paid if any of the following conditions exist:

9 1. The share draft was issued on or after the date of  
10 appointment of a receiver in the event of an involuntary  
11 dissolution, or on or after the date the credit union is  
12 required by section five hundred thirty-three point twenty  
13 (533.20), subsection two (2) of the Code to cease doing  
14 business in the event of a voluntary dissolution.

15 2. The obligation of the member which is evidenced by  
16 the share draft has been satisfied.

17 3. The share draft is written against an account which  
18 does not contain sufficient funds with which to pay the share  
19 draft.

20 4. The share draft is payable to a member of the credit  
21 union, or to a member of the family of the issuer of the share  
22 draft, or to a business in which the issuer of the share draft  
23 has an interest.

24 Sec. 3. Chapter five hundred thirty-three (533), Code  
25 1979, is amended by adding the following new section:

26 NEW SECTION. TERMINATION OF SHARE DRAFT PROGRAM. Failure  
27 to promptly honor share drafts written on accounts containing  
28 sufficient funds when presented for payment, or depletion  
29 of the share draft liquidity reserve below the minimum level  
30 specified in this Act, shall be grounds for terminating a  
31 share draft program and the administrator shall terminate  
32 the share draft program of a credit union demonstrating a  
33 continuing pattern of either practice. A credit union whose  
34 share draft program has been terminated under this section  
35 shall not be considered for authorization of a new share draft

1 program for at least two years after termination.

2 Sec. 4. Section five hundred thirty-three point six  
3 (533.6), subsection four (4), Code 1979, is amended to read  
4 as follows:

5 4. ~~If it shall appear~~ after notice and opportunity for  
6 hearing is given the administrator determines that any credit  
7 union is insolvent or that it has violated any of the  
8 provisions of this chapter, the administrator ~~may, after a~~  
9 ~~hearing or after an opportunity for a hearing is given,~~ shall  
10 order that credit union to correct the condition. The  
11 administrator shall grant the credit union not less than sixty  
12 days within which to comply with the order, except that a  
13 credit union shall be allowed only two business days to correct  
14 deficiencies in the liquidity reserve for share draft accounts.  
15 Failure to comply shall afford the administrator grounds to  
16 revoke the certificate of approval and shall afford the  
17 administrator the authority to apply to the district court  
18 of the district in which this credit union is located for  
19 the appointment of a receiver for the credit union. The  
20 district court shall appoint the administrator of the credit  
21 union department as receiver unless the administrator of the  
22 credit union department has tendered the appointment to the  
23 administrator of the plan by which the accounts of the credit  
24 union are insured. Either administrator as receiver shall  
25 possess the rights, powers, and privileges granted by state  
26 law to a receiver of a state credit union. Neither  
27 administrator shall be required to furnish bond as receiver  
28 of a state credit union.

29 Sec. 5. Notwithstanding other provisions of this Act,  
30 a credit union which has an operating share draft program  
31 as of the effective date of this Act may continue to offer  
32 share draft services prior to submitting a request and re-  
33 ceiving approval of the administrator as required by this  
34 Act, but the credit union must submit a request as required  
35 by this Act not later than sixty days after the effective

1 date of this Act. The administrator shall act upon the re-  
2 quest within thirty days after receiving it. The temporary  
3 authority granted by this section expires ninety days after  
4 the effective date of this Act, or on the date the adminis-  
5 trator acts upon the request for share draft authority,  
6 whichever date is earlier.

7 Sec. 6. Acts of the Sixty-seventh General Assembly, 1978  
8 Session, chapter one thousand one hundred ninety (1190),  
9 section twenty-three (23), is repealed.

10 Sec. 7. This Act, being deemed of immediate importance,  
11 shall take effect and be in force from and after its publica-  
12 tion in \_\_\_\_\_, a newspaper published in  
13 \_\_\_\_\_, Iowa, and in \_\_\_\_\_, a  
14 newspaper published in \_\_\_\_\_, Iowa.

15 EXPLANATION

16 This bill provides permanent authority for share draft  
17 accounts in credit unions, which replaces the temporary  
18 authority contained in section 23 of House File 2467, enacted  
19 during the 1978 session.

20 Section 1 of the bill requires that each credit union  
21 desiring to offer share draft services must apply to the  
22 credit union administrator for approval of the proposed  
23 program. Contents of the application are specified, along  
24 with conditions which must be satisfied before approval may  
25 be given. Among other things, the provisions of section 1  
26 require the identification of the bank through which the share  
27 drafts are payable, the operating procedures for share draft  
28 accounts, pre-printed share draft forms, periodic statements  
29 of accounts to members, procedures for stop-payment orders,  
30 and disclosure of share draft service fees.

31 Section 1 also requires that credit unions with share draft  
32 programs be insured by the federal credit union administrator,  
33 and that a liquidity reserve be established to ensure payment  
34 of share drafts. The liquidity reserve must be equal to at  
35 least 13 percent of the total amount of dollars in share

1 accounts and deposit accounts against which share drafts may  
2 be drawn, with 3/13ths of the reserve in cash on hand or  
3 demand deposits in state or national banks, and with the  
4 remainder of the reserve invested in United States treasury  
5 instruments owned by the credit union.

6 Section 2 provides that if a credit union is dissolved,  
7 outstanding third-party share drafts must be paid prior to  
8 distribution of assets or payment of obligations of the credit  
9 union.

10 Section 3 authorizes the credit union administrator to  
11 order a credit union to terminate its share draft program  
12 if there is a repeated failure to pay drafts promptly when  
13 presented, or a repeated failure to maintain the required  
14 liquidity reserve.

15 Section 4 authorizes the administrator to revoke the certif-  
16 icate of approval of a credit union which fails to correct  
17 a deficiency in its liquidity reserve within two business  
18 days after the administrator orders the correction.

19 Section 5 applies only to credit unions having share draft  
20 programs in operation as of the effective date of the Act,  
21 and it permits them to continue the program for up to 90 days  
22 following the effective date of the Act while the process  
23 of complying with the new statutory requirements is taking  
24 place.

25 Section 6 repeals the temporary authority contained in  
26 H.F. 2467.

27 The bill would take effect upon publication following its  
28 enactment.

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