



August 2, 2011

NCUA Credit Union Service Organization (CUSO) Proposed Rule

EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Board has proposed amending 12 C.F.R. Part 712 to expand reporting requirements for credit union service organizations (CUSOs). The proposed rule would require all CUSOs to file financial reports directly with NCUA and, if a federally-insured state-chartered credit union (FISCU) has invested in or made loans to the CUSO, the appropriate state supervisory authority (SSA). Any CUSO subsidiary would also have to comply with the regulation as though it were a CUSO if the rule is finalized as proposed.

In addition, the proposed rule would require FISCUs to comply with certain requirements regarding CUSOs that federal credit unions (FCUs) must currently meet, such as requiring a CUSO to agree to follow NCUA rules on accounting and allow supervisory access to its books and records, and making FISCUs subject to NCUA's CUSO investment limitations for less than adequately capitalized credit unions.

CUSOs that are owned by or borrow from FISCUs must already comply with Section 712.3(d)(3) (requiring CUSOs to provide NCUA and state regulators with "complete access to any books and of the CUSO and the ability to review CUSO internal controls . . .") and Section 712.4 (requiring CUSOs and credit unions to maintain separate corporate identities) of NCUA regulations. According to the agency, this proposal is necessary because of the lack of accurate and complete financial information about CUSOs "and their potential impact on the NCUSIF." The Board also said it is concerned about undercapitalized credit unions investing in CUSOs.

NCUA used to have statutory authority to examine CUSOs that were owned by or borrowed from federally-insured credit unions (FICUs) under former Section 206A of the Federal Credit Union Act, 12 U.S.C. § 1786a, as added by the Examination Parity and Year 2000 Readiness for Financial Institutions Act. Pub. L. No. 105-164 (1998). NCUA's Section 206A authorities expired on December 31, 2001. NCUA is therefore relying on its more general powers under the Act regarding safety and soundness requirements for FICUs as the statutory basis for this rule (as it did in its 2008 revisions to its CUSO regulations).

Comments are due to NCUA by September 26, 2011; **please submit comments to CUNA by September 16, 2011.** Please feel free to e-mail your responses to SVP and

Deputy General Counsel Mary Dunn (mdunn@cuna.coop), Senior Assistant General Counsel Michael Edwards (medwards@cuna.coop), or Regulatory Counsel Jared Ihrig (jihrig@cuna.coop). You can also mail them to CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, South Building, 6th Floor, Washington, DC 20004. You may access a copy of NCUA's proposal [here](#).

Comment letters may be filed with NCUA via email at regcomments@ncua.gov. If commenting directly to the agency, please include "[Your name] Comments on Notice of Proposed Rulemaking (CUSO)" in the e-mail subject line.

DESCRIPTION OF THE PROPOSED RULE

Proposed 12 C.F.R. § 712.2(d)(3)—“Special Rule in the Case of Less than Adequately Capitalized FICUs”

Proposed Section 712.2(d)(3) would expand to all FICUs the existing prohibition on less than “adequately capitalized”¹ FCUs investing in CUSOs without obtaining prior written approval from supervisory authorities. Currently, less than adequately capitalized FCUs must receive prior written approval from the NCUA Regional Office before making a CUSO investment if it would result in the FCU paying an aggregate cash outlay, measured on cumulative basis, in excess of 1 % of its “paid in and unimpaired capital and surplus.”²

In the case of a less than adequately capitalized FISCO, the proposal would require the FISCO to receive prior written approval from the appropriate SSA if the investment would result in an aggregate cash outlay, measured on cumulative basis, “in an amount that would be in excess of the investment limit in the state in which the [FISCO] is chartered.” The FISCO would be required to simultaneously submit a copy of its request to the appropriate NCUA Regional Office. If the state does not have a CUSO investment limit, the FISCO would be subject to the same limits as an FCU.

Proposed 12 C.F.R. § 712.3(d)—“CUSO Accounting; Financial Statements; NCUA Access to Information”

The proposal would require FISCUs and FCUs alike to include in any CUSO agreement a requirement that the CUSO account for all of its transactions according to Generally Accepted Accounting Principles (GAAP), prepare quarterly financial statements, obtain an annual financial statement audit by a licensed CPA, and file reports directly with regulators. More specifically, the proposal would set forth the following requirements:

1. New Reporting Requirements That Would Apply to FCUs' and FISCUs' CUSOs:

Under the proposal, all CUSOs that have investments in or loans from any FICU—i.e.

¹ In order to be “adequately capitalized” a FICU must: (i) have a net worth ratio of not less than 6 percent; and (ii) meet any applicable risk-based net worth requirement. 12 U.S.C. § 1790d(c).

² “Paid-in and unimpaired capital and surplus means shares plus post-closing, undivided earnings. This does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer.” 12 C.F.R. § 700.2(f).

FCUs and/or FISCUs—would be required to submit at least annually a financial report directly to NCUA and the appropriate SSA, if applicable. Currently, no CUSOs are subject to direct reporting requirements under NCUA regulations that are similar to those proposed by this rule. A CUSO’s direct financial reports would include:

- a. General information about the CUSO;
- b. A list of the CUSO’s services;
- c. The CUSO’s customer list;
- d. Information on the CUSO’s board and management; and
- e. The CUSO’s balance sheet and income information.

2. FCU CUSO Reporting Rules Would Apply to FISCUs: The proposal would expand to FISCUs the requirement that any credit union investing in or lending to a CUSO must require the CUSO to agree: (a) to give NCUA access to its books and records; (b) prepare quarterly financial statements and an annual audit under generally accepted auditing standards (GAAS); and (c) follow GAAP accounting (currently these requirements only apply to CUSOs that FCUs have invested in or made loans to).

Proposed 12 C.F.R. § 712.10—“How Can a State Supervisory Authority Obtain an Exemption for FISCUs from Compliance with § 712.3(d)?”

The proposed rule would amend Section 712.10 to allow SSAs to ask the NCUA Board to “exempt” FISCUs in particular states from the CUSO requirements under proposed 12 C.F.R. § 712.3(d)(1), (2), (3). The NCUA Board would grant such an exemption if it determines that the laws and procedures available to that state’s SSA “are sufficient to provide NCUA with the degree of access and information it believes is necessary to evaluate the safety and soundness of FICUs having business relationships with CUSOs owned by FISCUs in that state.”

Proposed 12 C.F.R. § 712.3(d)(1), (2), (3) would require FISCUs’ CUSOs to agree to follow GAAP, prepare quarterly financial statements and an audit performed under GAAS, and provide access to books and records, as outlined above under “2. FCU CUSO Reporting Rules Would Apply to FISCUs.”

The current version of 12 C.F.R. § 712.10 contains a similar exemption authority and similar requirements regarding NCUA’s “co-extensive authority” regarding access to CUSO books and records and so forth.

The exemption, as proposed, would not apply to the new proposed requirement for CUSOs to file reports with NCUA and/or the SSA pursuant to 12 C.F.R. § 712.3(d)(4) (as summarized above under “1. New Reporting Requirements That Would Apply to FCUs’ and FISCUs’ CUSOs”).

To obtain this exemption, the SSA would need to make a submission to the appropriate NCUA Regional Office, and the SSA would also need to agree to provide NCUA with “co-extensive authority” sufficient to allow NCUA “direct access to CUSO books and records at such times as NCUA, in its sole discretion, may determine necessary or appropriate.”

Proposed 12 C.F.R. § 712.11—“What Requirements Apply to Subsidiary CUSOs?”

The proposal would establish a new Section 712.11, which would require FCUs and FISCUs that invest in or make loans to CUSOs that invest in other companies (“subsidiary CUSOs”³) to obtain agreements from those CUSOs as follows:

- 1. FCUs Investing in a CUSO that Invests in a CUSO:** An FCU could only invest in a CUSO that has an investment in another CUSO if the “subsidiary CUSO” satisfies all of the requirements of NCUA’s Part 712 CUSO regulations.
- 2. FISCUs Investing in a CUSO that Invests in a CUSO:** A FISCU may only invest in or make a loan to a CUSO, which has an investment in another CUSO, if the “subsidiary CUSO” complies with the following:
 - a) All of the requirements of part 712 of NCUA’s rules that apply to FISCUs; and
 - b) All applicable state laws and rules regarding CUSOs.

Proposed 12 C.F.R. § 712.4—“What Must a FICU and a CUSO do to Maintain Separate Corporate Identities?”

CUSOs that FISCUs have invested in or made loans to must already comply with Section 712.4, including the requirement that the credit union must obtain a written legal opinion regarding whether “the CUSO is established in a manner that will limit potential exposure of the FICU to no more than the loss of funds invested in, or lent to, the CUSO.” Existing Section 712.4 only refers to FCUs, however, with the requirement for FISCUs applying pursuant to 12 C.F.R. § 741.222 (which is discussed below).

The proposal therefore seeks to clarify the application Section 712.4—by changing “FCU” to “FICU”—but would not impose new substantive requirements on FISCUs (because these requirements already apply to FISCUs pursuant to 12 C.F.R. § 741.222).

Section 712.4, under both existing law and as proposed, requires CUSOs and FICUs to ensure that:

- 1) Respective business transactions, accounts, and records are not intermingled;
- 2) Each observes the formalities of its separate corporate procedures;
- 3) Each is adequately financed as a separate unit in the light of normal obligations reasonably foreseeable in a business of its size and character;
- 4) Each is held out to the public as a separate enterprise;
- 5) The FICU does not dominate the CUSO to the extent that the CUSO is treated as a department of the FICU; and

³ The proposed rule’s preamble states that “a subsidiary CUSO is any entity in which a CUSO invests. The definition of a subsidiary CUSO, however, does not extend to outside third parties a CUSO contracts or otherwise does business with, but is limited only to those entities in which the CUSO has made an investment.” 76 Fed. Reg. 44866, 44867 (proposed July 27, 2011).

- 6) Unless the FICU has guaranteed a loan obtained by the CUSO, all borrowings by the CUSO indicate that the FICU is not liable.

Proposed 12 C.F.R. § 741.222—“Credit Union Service Organizations”

Proposed Section 741.222 would amend NCUA’s share insurance regulations to list the Part 712 CUSO regulations that apply to FISCUs as follows:

- 12 C.F.R. § 712.2(d)(3) (“Special Rule in the Case of Less than Adequately Capitalized FICUs”);
- 12 C.F.R. § 712.3(d) (“CUSO Accounting; Financial Statements; NCUA Access to Information”);
- 12 C.F.R. § 712.4 (“What Must a FICU and a CUSO do to Maintain Separate Corporate Identities?”); and
- 12 C.F.R. § 712.11 (“What Requirements Apply to Subsidiary CUSOs?”).

Proposed Section 741.222 also states that it “has no preemptive effect with respect to the laws or rules of any state providing for access to CUSO books and records or CUSO examination by credit union regulatory authorities.”

QUESTIONS TO CONSIDER REGARDING THE PROPOSAL

1. Do you support the proposed 12 C.F.R. § 712.3(d) reporting requirements that would require all CUSOs to file reports directly with NCUA and/or the appropriate SSA (which would include information such as the CUSO’s balance sheet and income statement)? If not, why not?

2. Do you support the proposed revisions to 12 C.F.R. § 712.3(d) and § 741.222 that would make it a condition of federal share insurance for FISCUs to require their CUSOs to agree: (a) to give NCUA access to its books and records; (b) prepare quarterly financial statements and an annual audit under GAAS; and (c) follow GAAP accounting? If not, why not?

3. Do you support the proposed expansion of the existing 12 C.F.R. § 712.2(d)(3) “Special Rule in the Case of Less than Adequately Capitalized FCUs”—which requires less than adequately capitalized credit unions to seek supervisory approval before making CUSO investments—to apply to all FICUs? If not, why not?

4. Do you think that the proposed “exemption” that SSAs can seek for FISCUs pursuant to 12 C.F.R. § 712.10 (“How Can a State Supervisory Authority Obtain an Exemption for FISCUs from Compliance with § 712.3(d)?”) is a meaningful exemption? If not, how could the “exemption” be improved?

5. Do you support the proposed approach to treating subsidiaries of CUSOs as “subsidiary CUSOs” subject to NCUA’s CUSO regulations to the same extent as a normal CUSO?

6. NCUA’s Paperwork Reduction Act analysis does not provide estimates of the proposal’s regulatory burden on CUSOs, but does provide the following paperwork-related regulatory burden estimates for credit unions:

- A one-time, one hour regulatory burden on FISCUs for changing their written agreements with CUSOs regarding accounting and reporting requirements;
- A one-time, one hour regulatory burden on FCUs for changing their written agreements with CUSOs regarding reporting requirements; and
- A one-time, two hour regulatory burden on less than adequately capitalized FISCUs with a CUSO interest to complete a request for approval to recapitalize an insolvent CUSO.

NCUA did not perform a Regulatory Flexibility Act analysis because “NCUA has determined . . . that the final rule will not have a significant economic impact on a substantial number of small credit unions.” (NCUA defines “small credit unions” as credit unions with less than \$10 million in assets.)

Please consider these questions regarding NCUA’s regulatory burden analyses:

a. Do you think that these paperwork regulatory burden estimates are accurate, or do they underestimate this rulemaking’s burden on credit unions?

b. What is your credit union’s estimate of the proposal’s likely regulatory burden on your institution (including paperwork as well as other regulatory burdens)?

c. Should NCUA also consider the proposal’s impact on CUSOs as well as its impact on credit unions?