



September 26, 2011

Mary Rupp  
Secretary to the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314

Re: NASCUS Comments on Notice of Proposed Rulemaking (CUSO) 12 CFR Parts 712  
and 741 RIN 3133-AD93

Dear Ms. Rupp:

The National Association of State Credit Union Supervisors (NASCUS)<sup>1</sup> appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) concerning the proposed rule to further extend NCUA regulatory authority into Credit Union Service Organizations (CUSOs). NCUA's concern regarding the potential *for some* CUSOs to expose their credit union owners to material risk is understandable. Those concerns are shared by NASCUS and state regulators, and we agree that taking steps to improve regulatory understanding and enhance monitoring of material risks presented through CUSOs is prudent. However, after careful consideration and deliberation, we cannot support NCUA's current proposal.

As explained in more detail below, the proposed rule is flawed. It is overly broad, and will unnecessarily drain the resources of both regulators and the industry by capturing information even from CUSOs engaged in services with minimal balance sheet safety and soundness implications. For CUSOs engaged in a business that is regulated at the state and/or federal level, the proposal fails to consider that its reporting requirements may be redundant.

The proposed rule is also vague in many critical respects. It would require CUSOs to submit to NCUA a list of customers and services offered without elaborating whether the requirements are limited to credit union customers and credit union services. The supplemental information accompanying the proposed rule also lacks any discussion of how NCUA will evaluate information submitted or will guarantee the confidentiality of *all* information submitted under the proposed rule.

Furthermore, NCUA's authority to require direct reporting by CUSOs is ambiguous and likely to invite challenge by litigation. It would be counterproductive at this point in the stabilization and reform of the credit union system to invite the cost and uncertainty of litigation when established means already exist to target oversight of CUSOs that present a material risk.

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<sup>1</sup> NASCUS is the professional association of the nation's state credit union regulatory agencies.

From a holistic perspective, the fundamental problem with NCUA's proposed approach is that it *focuses supervisory oversight on CUSOs*. The efforts of state and federal credit union regulators should focus on the *credit union's relationship with its CUSO*. Existing rules and regulations directly applicable to federally insured credit unions provide ample authority to review relevant information on that relationship.

We recommend NCUA work with state regulators to refine oversight of the CUSO activities of federally insured credit unions through existing regulatory authority rather than proceed with the current proposal.

### The Proposed Rule Lacks Targeted Focus

As drafted, NCUA's proposed rule is overly broad and not targeted to potential material risk presented by CUSOs. As noted above, state regulators concur that some credit union/CUSO relationships necessitate closer scrutiny, and possibly more information. However, as proposed, NCUA's rule does not target efforts where needed.

The proposed rule (and NCUA's existing rule) should distinguish between credit unions with investments in CUSOs and credit unions that merely make loans to CUSOs in which they have no ownership interest. Albeit rare, a credit union's loan to a CUSO, absent any ownership interest, presents only the risk of a commercial loan and should be treated differently than loans coupled with an investment/ownership interest.<sup>2</sup>

CUSOs are formed to provide credit unions with a myriad of products and services. Some of these are financial products and services with associated risks, others are non-financial with *de minimus* risk. The proposed rule makes no distinctions, even though the financial statements of CUSOs engaged in non-financial services should generally be of little interest to regulators. Final regulations including these CUSOs would be unnecessarily burdensome while providing little value to regulators.

By failing to target its application, the proposed rule would also unnecessarily burden regulators as well. By sweeping in many entities that may represent non-material risk, the proposed rule would drain state and federal examination resources on examining and cataloging data from these CUSOs, reducing the resources available to address more pressing risks in the credit union system.

### Reliance on the Call Report and Access to Books and Records

The credit union 5300 Call Report provides a means to capture identifying information on CUSOs and information regarding the credit union's financial involvement in the CUSO. Information currently captured on 5300 Call Reports includes: the CUSO's federal tax identification number, name, the credit union's equity interest in the CUSO, loans to the CUSO, cash outlays made to the CUSO, and services provided by the CUSO.<sup>3</sup>

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<sup>2</sup> Concerns regarding "quid pro quo" loans should be addressed with a provision making it a violation of Part 741.222 and Part 712 to arrange a transaction for the purpose of evading the rules.

<sup>3</sup> NCUA 5300 Call Report, Schedule C.

NCUA cites the unreliability of Call Reports as necessitating the proposed rule. 76 Federal Register 144 (July 27, 2011) p. 44868. The issue of inaccurate Call Report data is better handled by enforcing timely and accurate filing by credit unions.

If, based on the Call Report data, material risk related to a CUSO is identified, then NCUA and state regulators have the authority to access the CUSO's books and records. This should provide sufficient oversight to satisfy most regulatory concerns. If the Call Report currently does not require submission of needed information, it should be amended. If credit unions fail to provide accurate and timely required information then the consequences should be enforcement actions.

### Risk of De-emphasizing Third Party Due Diligence

In 2007, NCUA issued comprehensive guidance on regulatory expectations for credit union third party due diligence.<sup>4</sup> This guidance remains a standard for credit union due diligence, and should with proper emphasis (and implementation) result in credit unions gathering and analyzing much of the very information NCUA seeks in the proposed rule. Ultimately, credit unions must understand the financial condition of their CUSOs. In addition, due diligence requirements extend beyond a credit union's ownership interest in a CUSO. These requirements attach to many of the products and services credit unions utilize such as loan participations, indirect lending, and member business lending.

Such a direct regulatory involvement with CUSOs creates the risk that credit unions will relax their third party due diligence in reliance on "regulatory oversight" of the CUSO. This dynamic was evidenced after the conservatorship of the five federal corporate credit unions. Many in the credit union system wished to hold regulators accountable for the corporate losses on the grounds that the corporates were presumed to be sound investments because they were examined by NCUA. Of course, this sentiment is misplaced, and regulatory examination or oversight of a CUSO is not a substitute for a credit union's own due diligence.

The better approach to evaluating the credit union/CUSO relationship would be to emphasize credit union due diligence as part of the routine examination. If during the course of an examination regulators conclude more detailed review of the CUSO is necessary, then authority already exists at the state and federal levels to obtain additional information as needed.<sup>5</sup>

### Leveraging Existing State and Federal Regulatory Oversight of CUSOs

With very few exceptions, CUSOs are state corporations that in some cases may be regulated by a state authority. Others may be regulated by federal authorities. For example, CUSOs engaged in insurance, securities, and mortgage brokerage activities are licensed and regulated at the state level. Other CUSOs may be regulated by the Securities and Exchange Commission (SEC) or be subject to oversight by the Office of the Comptroller of the Currency (OCC) or by the Federal

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<sup>4</sup> NCUA Letter to Credit Unions 07-CU-13, *Third Party Due Diligence* (December 2007).

<sup>5</sup> Numerous state laws and regulations provide authority for state regulators to examine CUSOs as needed. See also 12 C.F.R. 712.3(d)(3) (requiring state and federal access to a CUSO's books and records).

Deposit Insurance Commission (FDIC).<sup>6</sup> It would be more efficient to leverage existing oversight rather than layer on additional regulations.

For example, CUSOs engaged in mortgage lending are required by the SAFE Act to file detailed quarterly financial statements with the NMLS.<sup>7</sup> Another example would be a CUSO engaged in the business of insurance. These entities are highly regulated at the state level, file annual financial statements with regulators, and in some cases file reports with the Securities and Exchange Commission (SEC). NCUA should consider coordinating with the National Association of Insurance Commissioners (NAIC) for CUSOs engaged in the business of insurance.

At a minimum, NCUA should exempt state or federally regulated CUSOs from the new rules, or seek a Memorandum of Understanding (MOUs) with regulatory entities to leverage existing oversight before adding additional regulatory burden on credit unions and their CUSOs. NASCUS would be willing to work with NCUA to facilitate the execution of MOUs with state entities.

### Ambiguous Legal Authority

In 1998, Congress extended to NCUA broad, and direct, regulatory authority over CUSOs.<sup>8</sup> However, at the time the authority was granted, Congress chose to limit the duration of that authority, having it sunset in December of 2001. Since that time, although NCUA has sought permanent CUSO regulatory authority, Congress has not renewed NCUA's CUSO authority.

It is well established that a regulatory entity may not use regulation to expand the authority beyond that vested in it by statute. As a federal court said, "...power to issue regulations is not power to change the law..." *US v. New England Coal and Coke Company*, 318 F.2d 138, 152, (1st Cir. 1963). Should this proposal be finalized, NCUA's authority over CUSOs would be indistinguishable from the third party authority Congress has declined to re-authorize for the agency.

NCUA should seek from Congress the authority to regulate CUSOs before promulgating final rules as expansive as this proposal.

### Use and Disclosure of Information Collected

The proposal is unclear as to how the information reported directly by CUSOs would be used. If NCUA intends to review the financial performance of every CUSO and issue to that CUSO's credit union owners a report on the Agency's conclusions, this should be made clear. If that is NCUA's intent, it would be helpful for NCUA to discuss the expertise it intends to develop to evaluate the performance and business models of CUSOs engaged in a myriad of businesses. If

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<sup>6</sup> For example, CUSOs owned by or providing services to a federally insured bank.

<sup>7</sup> To view a sample of the nature of financial information required, see: <http://mortgage.nationwidelicencingsystem.org/slr/common/mcr/NMLS%20Document%20Library/Standard-MCR-Practice-Worksheet.pdf>

<sup>8</sup> *Examination Parity and Year 2000 Readiness for Financial Institutions Act*, P.L. 105-164.

it is not NCUA's intention to evaluate the report submitted by every CUSO, then the proposal is unnecessarily broad and a drain on both credit union and regulator resources. On those grounds alone the proposal should be abandoned.

In discussions with NASCUS, and in comments already filed with NCUA, the industry has expressed concerns about NCUA's ability to shield information from Freedom of Information Act (FOIA) requests for information annually reported by CUSOs. Although numerous exemptions to FOIA disclosures exist to protect trade secrets and financial information, the legal issues involved with FOIA are complex.<sup>9</sup> NCUA should determine if submitted CUSO information would be "voluntary" or "required" for FOIA analysis and ensure information submitted would be exempt from FOIA requests.<sup>10</sup>

### Clarification of Proposed Rule

Many provisions of NCUA's proposed rule need clarification. Proposed Part 712.2(d)(3)(ii) would prohibit a less than adequately capitalized credit union from making an additional investment or loan to a CUSO if that investment or loan would cause the credit union's "aggregate cash outlay" to the CUSO to exceed the state CUSO investment limits (in the case state-chartered credit unions). 76 Federal Register 144 (July 27, 2011) p. 44868. However, it is unclear from the proposed rule how far back in time the cash outlays are aggregated. If NCUA intends the aggregation to go back to "day one, dollar one" that should be made clear in the definition of "aggregate cash outlay."

Proposed Part 712.3(d)(4)(i) would require CUSOs to submit directly to NCUA an annual report including, among other things, a list of the CUSO's services and customers. 76 Federal Register 144 (July 27, 2011) p. 44869. The proposal is unclear whether NCUA intends the CUSO to provide a list of *credit union* customers and *credit union* services. The proposal could be read to require a list of all real person customers and non-credit union services, both of which are impractical.

### Part 741 Should Contain All Provisions Applicable to State-Chartered Federally Insured Credit Unions

NASCUS has long urged NCUA to ease the regulatory burden on state-chartered federally insured credit unions by incorporating insurance rules into Part 741 in their entirety rather than by reference. NCUA has to date declined to do so and the result is a set of rules and regulations that remain confusing. The convoluted nature of NCUA's rules make it difficult for state-chartered credit unions, as well as state and federal examiners, to easily discern which rules, or in some cases portions of rules, apply.

In its CUSO proposal, NCUA includes several state-chartered federally insured credit union specific paragraphs in addition to provisions for federal credit unions. Those state credit union

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<sup>9</sup> 12 C.F.R. 792.11(a)(4).

<sup>10</sup> *Critical Mass Energy Project v. NRC*, 975 F.2d 871 (D.C. Cir. 1992) and *National Parks & Conservation Ass'n v. Morton*, 498 F.2d 765, 770 (D.C. Cir. 1974).

provisions could just as easily be included in the text of Part 741.222, the NCUA rule addressing CUSO requirements for state-chartered credit unions.

In addition to consolidating its insurance rules in one chapter of its Rules and Regulations, NCUA should also improve its web-based resources for all federally insured credit unions seeking to consult regulations. Currently on its website, NCUA provides one complete version of the rules as of March 2010. In addition, thirty (30) additional final rules are provided separately which must be consulted in order to ensure the reader is reviewing the most up to date information. Providing a current complete set of rules must be a priority for NCUA.

### The Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)

Under the SAFE Act, employees of subsidiaries of depository institutions must either be licensed or registered by the NMLS if those employees qualify as mortgage loan originators (MLOs). Whether a subsidiary's MLOs must register or be licensed is determined by whether the parent depository institution's federal regulator also regulates the subsidiary. For banks, federal bank regulators determined that the subsidiaries were regulated for purposes of the SAFE Act. NCUA however determined CUSOs were not regulated and therefore subject to licensing rather than registration. OGC Opinion 08-0843 (October 3, 2008).

Given that the proposed rule would extend NCUA oversight to CUSOs, including requiring reporting and adherence to NCUA rules, NCUA should address whether this level of supervision qualifies CUSOs as regulated subsidiaries and eligible for registration in the future.

### Exemptions for State-Chartered Credit Unions

NCUA's proposal would extend the state authority exemption process provided by existing Part 712.10 to the new proposal with the exception of the financial reporting requirement. We believe the exemption process should be applicable to the CUSO rule in its entirety. The "dual banking system" in the United States has been a stalwart of the financial services market place, driving innovation in the industry's operations and oversight. Where state regulation and oversight mitigate risk to an equal extent as NCUA's supervision, then NCUA should exempt those state-chartered credit unions from federal rules. In the case of the relationship between a state credit union and its CUSOs, NCUA's rules should allow the state to mitigate the risk by varying methods.

### In Conclusion

NASCUS and state regulators remain committed to working with NCUA to mitigate material risk throughout the credit union system, and appreciate the opportunity to submit comments on this proposed rule. To reiterate, we agree that fully understanding the nature and condition of a credit union's investment in a CUSO may in some cases be essential for regulators. At the state level many regulators have expanded authority over CUSOs that may be exercised as needed. That is why NASCUS has in the past supported NCUA efforts to obtain statutory third party authority on par with the states and federal bank regulators. In 2008 when NCUA sought to

extend books and records access regulations to state-chartered federally insured credit unions, NASCUS did not oppose the rulemaking.

We urge NCUA to reconsider this proposal and work with state regulators to enhance supervision through improving existing authority and monitoring programs. We are confident that working together, NCUA and state regulators can develop a targeted CUSO supervision program that addresses legitimate regulatory concerns while preserving the benefits CUSOs provide the credit union system.

Sincerely,

- signature redacted for electronic publication -

Brian Knight  
SVP Regulatory Affairs & General Counsel