

14-CU-07 Contractual Agreements with Credit Union Service Organizations (CUSOs)

Summary

*Prepared by NASCUS Legislative & Regulatory Affairs Department
June 2014*

NCUA has issued Letter to Credit Unions 14-CU-07 (LTCU 14-CU-07) to remind credit unions that have an outstanding loan to a CUSO or an investment in a CUSO that they are required to amend their contractual agreement with that CUSO by **June 30, 2014**.

Under NCUA's most recent [CUSO rule](#), finalized in November 2013, credit unions lending to or investing in CUSOs must enter into a written agreement requiring that CUSO to submit annual reports directly to NCUA and the state regulator (if state-chartered).

Credit unions that receive products and services from CUSOs but do not have an investment in or loan outstanding to a CUSO are not subject to this contractual agreement/reporting requirement.

The type of required reporting will depend on the kinds of activities that the CUSO is engaged in:

All CUSOs: Regardless of their products and services, all CUSOs must furnish to NCUA:

- The CUSO's Tax ID number and legal name
- The CUSO's address, telephone number, URL, and contact person
- Services offered by the CUSO
- List of all FICUs that invest in, lend to, or receive services from the CUSO
- Information on any parent, or subsidiary, CUSOs

Complex or High Risk CUSOs: CUSOs that offer complex or high risk services must provide additional information. NCUA defined complex/high risk as CUSOs that provide credit and lending, information technology, custody, safekeeping, and investment management services for FICUs. These CUSOs must provide NCUA:

- List of services provided each FICU client/customer
- Investment, loan, or level of activity of each FICU
- Annual financial statements

Credit or Lending CUSOs: CUSOs that provide credit or lending services must also provide:

- Total dollar amount of loans outstanding
- Total number of loans outstanding
- Total dollar amount of loans granted year-to-date
- Total number of loans granted year-to-date

Additional reference materials include:

- Letter to Credit Unions, 13-CU-13 [Changes to NCUA Regulations Related to Credit Union Service Organizations](#)
- NCUA Final Rule, 12 CFR Parts 712 and 741, [Credit Union Service Organizations](#)
- Demonstrates additional risk mitigation factors for longer amortizations and interest only loans

Additionally, the credit union's underwriting and documentation should demonstrate an understanding of the following:

- Ownership of the borrowing entity
- Borrower's business type and structure
- Borrower's business operation and revenue generation
- The background, identity, and role of all principles
- History of the borrower and business entity
- Any potential interrelationships between separate taxi medallion borrowers

Borrower's Financials

NCUA instructs its examiners to pay particular attention to whether the quality of the financial information used in the financial analysis is commensurate with the level of risk and complexity of the borrower and principals' operations.

- For less complex loans, the tax return from the borrower and principal and personal financial statements are generally sufficient.
- For more complex borrowing relationships such as when there are multiple, integrated, businesses and medallions, credit union should require borrowers and principals to provide financial statements prepared in accordance with GAAP and subjected to a review engagement or audit by a CPA. In some cases, the complexity of the interconnectedness justifies enhanced due diligence. This would entail obtaining consolidated GAAP financial statements.

Credit unions should perform a global cash flow analysis for all borrowers and guarantors, including analysis of a global consolidation of the principal's activities for complex borrowers. The analysis should be included with the credit approval document. If a credit union relies on sources of repayment other than the borrowers operations, than the credit union must ensure that those sources are obligated to repay as co-borrowers or loan guarantors.

If the borrower is a new entity, without a financial history sufficient to establish cash flows to support the proposed debt, the credit union must validate financial projections prepared by the borrower. If the borrowing is for a new entity owned by principals that are already active in the taxi medallion business, the credit union should validate financial projections against the actual operational performance of similar business/taxi operations that are owned and operated by the principal.

Loan Documentation

In reviewing loan documentation, NCUA examiners will review the following:

- That loan documents establish a valid obligation, are properly executed, and that the security interest in the taxi medallion is perfected
- That licensing rights have been assigned to the credit union and that lien has been recorded in accordance with the appropriate local taxi authority and UCC requirements

- That loan documents incorporate the use of loan and financial covenants requiring the submission of financial information at least annually and providing the credit union the authority to otherwise monitor the financial condition of the borrower and guarantor

NCUA recommends, but does not require, credit unions obtain a legal opinion that the loan documentation creates an enforceable obligation, and the lien process achieves lien perfection, in the applicable jurisdiction.

Servicing Procedures and Risk Management Controls

NCUA examiners have also been instructed to evaluate credit unions' servicing procedures and risk management controls for taxi medallion loans. Credit unions should:

- Perform regular reviews, and risk modeling to test the overall taxi medallion loan portfolio's durability in the face of changes in market conditions, interest rates, and collateral values
- Take necessary precautions to limit exposure and/or adjust underwriting standards when premium market prices significantly exceed the value supported by the net operating income (NOI) the medallion generates
- Conduct periodic reviews and visits with the borrower, including a review of the operational and financial condition of the borrower and principal
- Conduct annual relationship reviews

Refinancing of Taxi Medallion Loans

Refinancing must be supported by a specific business purpose and benefit. NCUA instructs its examiners to ensure the credit union fully explains and justifies all cash-out refinancing. The proposed use of the funds should be outlined in detail in the credit approval document and tracked to confirm the funds were used for the approved and intended purpose.

Additional Guidance Relevant to Taxi Medallion Lending

NCUA references past guidance and encourages examiners to utilize those as well when scrutinizing a taxi medallion lending program. The additional guidance referenced are NCUA Supervisory Letter 13-0, [Evaluating Credit Union Requests for Waivers of Provisions in NCUA Rules and Regulations Part 723, MBLs](#); NCUA LTCU 13-CU-07, [Loan Participation Waivers](#); NCUA LTCU 10-CU-03, [Concentration Risk](#); NCUA Accounting Bulletin 06-01, [Interagency Policy Statement on the Allowance for Loan and Lease Losses](#).