

# Final Rule Summary

*Prepared by the NASCUS State Regulatory Affairs Department*

*November 25, 2013*

## **National Credit Union Administration**

## **12 CFR Parts 712 and 741 Credit Union Service Organizations**

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The National Credit Union Administration (NCUA) has issued a final rule expanding elements of the existing CUSO regulation to federally insured, state-chartered credit unions (FISCUs) and requiring all CUSOs to submit certain information directly to NCUA and state supervisory authorities. The rule calls for the creation of a registry system, managed by NCUA, that will house basic profile information for all CUSOs, and more detailed financial and customer information for those CUSOs engaged in “complex or high-risk activities.” These changes are amendments to 12 CFR Part 712, and are applicable to FISCUs pursuant to Part 741.222.

*The Rule takes effect on June 30, 2014; reporting requirements are effective when the registry becomes operational on December 31, 2015.*

### **Rule at-a-Glance:**

- Expands CUSO regulations to FISCUs concerning permissible investment limits for less than adequately capitalized credit unions, and requires FISCUs to obtain a written agreement from CUSOs that they will conduct annual audits of financial statements and use GAAP accounting principles (along with the existing requirement to provide NCUA with access to their books and records).
- Authorizes the development of a CUSO registry system that will be developed in-house by NCUA. The rule provides for \$750,000 in development costs for 2014, and anticipates an additional \$650,000 in system deployment costs in 2015. The registry is expected to be fully operational by December 31, 2015.
- Requires all CUSOs to register and report basic information directly to the NCUA, including legal name, tax id, and names and charters of credit unions that invest, lend, or receive services from the CUSO.
- CUSOs performing certain “complex or high-risk” (as defined by NCUA) activities or services must submit audited financial statements, as well as a list of services provided to each credit union with the investment amount, loan amount, or level of activity of each credit union.

- CUSOs engaged in credit or lending services must disclose the total number of loans outstanding, total dollar amount outstanding, total number of loans year-to-date, and total dollar amount of loans granted year-to-date, broken out by loan type.
- FISCUs may be granted an exemption from the accounting, financial statement and audit requirements of the rule if the state in which the FISCU is located has regulations that are at least equal to the requirements under 712.3(d)(1)-(3). No federally insured credit union, however, is eligible for an exemption from the registry requirements of 712.3(d)(4).
- The requirements of this part that apply to FISCUs apply to all tiers or levels of a CUSO's structure, including any subsidiaries of the CUSO.

**The final rule may be read [here](#).**

### **Background**

In 2008, NCUA promulgated a final rule that expanded certain elements of the CUSO regulations to FISCUs. The rule required FISCUs to maintain separate corporate identities from their CUSOs, and to enter into agreements with their CUSOs to provide NCUA with open access to their books and records. The NCUA Board, however, felt that the information collected was insufficient to provide a clear picture of CUSO use in the credit union system.

In order to identify emergent risks posed by CUSOs, NCUA felt that more comprehensive reporting was needed directly from the CUSOs themselves. In July 2011, NCUA issued a proposed rule that expanded accounting, financial statements, and audit requirements to FISCUs and mandated submission of financial reports from CUSOs directly to the NCUA. During the public comment period, NASCUS, along with a majority of other stakeholders, expressed concerns with the proposed rule.

In our comment letter, NASCUS expressed support for NCUA seeking Congressional approval of regulatory authority over third-party service providers, but questioned whether NCUA had the necessary authority to implement the rule, absent a statutory grant of authority from Congress. In addition, NASCUS urged NCUA to tailor the proposed rule to focus on those CUSOs that provide financial or other vital services to credit unions, and to utilize existing registration systems rather than attempting to build a new system at credit unions' expense. NCUA proceeded to a final rule on November 21, 2013.

### **Summary of Part 712.1; What does this part cover?**

The final rule expands the requirements of the CUSO regulation to FISCUs in several new areas including permissible investment limits for less than adequately capitalized credit unions, and agreements between credit unions and their CUSOs. This section also includes a new definition of CUSO, which incorporates any entity in which a FICU has any ownership interest or to which a FICU has made a loan if the entity is engaged primarily in providing products or services to credit unions and credit union members.

### **Summary of Part 712.2; How much can a FCU invest in or loan to CUSOs, and what parties may participate?**

The final rule prohibits a FICU that is less than adequately capitalized from recapitalizing a CUSO without prior written approval from the state regulator, if the investment would result in an aggregate cash outlay that exceeds the investment limit in the state in which it is chartered. FISCUs must also simultaneously submit a copy of the request to the NCUA regional office. If the state in question has no investment limit, the FICU must seek prior written approval from the state regulator to recapitalize the CUSO if the investment would exceed the federal limit of 1% paid-in and unimpaired capital and surplus.

### **Summary of Part 712.3; What are the characteristics of and what requirements apply to CUSOs?**

The final rule amends 712.3(d) to create a three-tier system of reporting requirements for CUSOs. NCUA plans to develop and maintain a registry that will encompass all CUSOs operating in the credit union industry. The registry will capture the basic registration information of all CUSOs, and will gather financial and customer information for CUSOs that perform financial, technological or security functions for credit unions. The NCUA Board approved \$750,000 to cover system development costs for the registry in 2014, and the rule noted that another \$650,000 in deployment costs are anticipated in 2015. NCUA asserted that the system would be fully operational by December 31, 2015. All of the direct reporting requirements outlined below will become effective once the registry becomes operational.

#### **All CUSOs:**

The final rule extends to FISCUs some of the requirements that were previously confined to FCUs. Prior to this final rule, FISCUs were only required to ensure NCUA's access to their CUSO's books and records, and the ability to review the CUSO's internal controls as necessary. The new final rule requires all federally insured credit unions to obtain a written agreement from their CUSOs mandating use of GAAP accounting practices and annual audits of financial statements by a licensed certified public accountant (unless wholly-owned and included in the annual audit of the FICU). These additional requirements used to apply only to FCUs, and FISCUs will have until June 30, 2014 to bring their agreements with CUSOs into compliance. In addition, all CUSOs must now submit a report directly to NCUA, via the registry system, containing the CUSO's:

- 1) Legal name;
- 2) Tax identification number;

- 3) Address;
- 4) Phone number;
- 5) Website;
- 6) Primary point of contact;
- 7) Services offered;
- 8) Names and charters of credit unions investing in, lending to, or receiving services from the CUSO; and
- 9) Any investor and/or subsidiary CUSOs.

*Complex or High-Risk CUSOs:*

The final rule includes a specific list of activities that NCUA considers “complex or high-risk,” such as electronic transaction services, record retention, security, and disaster recovery services, payroll processing, or custody, safekeeping, and investment management services. CUSOs performing these activities for credit unions must provide more detailed information in their annual report than the basic registration information required for all CUSOs, including their most recent year-end audited financial statements, and a list of services provided to each credit union with the investment amount, loan amount, or level of activity of each credit union.

*Credit and Lending CUSOs:*

CUSOs engaged in loan origination or servicing will face an additional level of regulatory disclosures. Using the NCUA developed registry system, CUSOs engaged in credit and lending services must disclose their total number of loans outstanding, total dollar amount of loans outstanding, total number of loans granted year-to-date, and total dollar amount of loans granted year-to-date, broken out by loan type. NCUA has asserted that CUSOs’ confidential business information will be protected from FOIA requests under exemption 4 for trade secrets and confidential information, and exemption 8 for information contained in or related to examination, operating, or condition reports.

**Summary of Part 712.4; What must a FICU and a CUSO do to maintain separate corporate identities?**

This section is amended to apply to all federally insured credit unions, instead of just federal credit unions. In addition, subsection (b) was tweaked to provide that the legal advice required under that section must be obtained in writing, from independent legal counsel. The legal advice must address whether the CUSO is established in a manner that will limit the potential exposure of the credit union to no more than the loss of funds invested in, or loaned to, the CUSO.

**Summary of Part 712.10; How can a state supervisory authority obtain an exemption for FISCUs from compliance with 712.3(d)(1), (2), and (3)?**

Before this final rule, FISCUs were only subject to 712.3(d)(3), which required that they provide NCUA with complete access to the books and records of all CUSOs, and allow NCUA to review the CUSO's internal controls, as necessary. A state supervisory authority could apply for an exemption from that requirement for FISCUs located within the state. This final rule expands the existing regulation to require all CUSOs to account for transactions in accordance with GAAP (712.3(d)(1)), as well as prepare quarterly financial statements and obtain annual audits (712.3(d)(2)).

In order to secure an exemption from all three sections, the final rule specifies that the NCUA Board must determine that the state's laws are "equal to, or more stringent than," NCUA requirements. This is a higher standard than the previous condition to secure an exemption, which only required that the NCUA Board determine that the state had "sufficient authority" to provide NCUA with necessary access to the books and records of the CUSO.

The new rule also includes a registry and reporting requirement for all CUSOs that is designed to provide a comprehensive view of the role that CUSOs play in the credit union industry. Accordingly, no CUSOs, including those utilized by FISCUs, will be eligible for an exemption from the new registration and reporting requirements contained in 712.3(d)(4). In addition, a new subsection was added to this section requiring the state to provide copies of the CUSO's financial statements and reports to NCUA on request.

**Summary of Part 712.11; What requirements apply to subsidiary CUSOs?**

The final rule adds this new sub-section to Part 712 to address what reporting requirements apply to subsidiary CUSOs. A subsidiary CUSO is defined as any entity in which a CUSO has any ownership interest, if that entity primarily provides products or services to credit unions or credit union members. The sub-section differentiates between subsidiaries of federal credit union CUSOs and subsidiaries of FISCU CUSOs. On the federal side, a subsidiary CUSO must fulfill all of the requirements of part 712. For FISCUs, subsidiary CUSOs must comply with all applicable state laws and rules, as well as all section of part 712 that apply to FISCUs. In both instances, the sections of part 712 that apply to the CUSO also apply to all tiers or levels of the CUSO's structure.

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