THE NATIONAL CENTER FOR
COLLABORATION & INNOVATION

August 4, 2011

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
Email: regcomments@ncua.gov

Re: Comments to the Proposed Amendments to the NCUA Regulations re: CUSOs 12 CFR Parts 712 and 741

Dear Ms. Rupp:

The National Association of Credit Union Service Organizations consists of credit union industry professionals who are dedicated to strengthening credit unions through collaboration. Now more than ever, credit unions need to find ways to generate net income to survive. Credit unions cannot live solely off the net interest margin as they did for decades. New services and new sources of income, safely and soundly delivered, and with appropriate risk mitigation, are needed. Credit unions need to be more efficient and lower operating costs. CUSOs have served as the means for credit unions to innovate, meet their members' financial needs and often times to do so in a shared ownership/shared risk format. There are many examples of credit unions adding significant sums, many over a million dollars a year, to their net income through income and/or savings generated through CUSO relationships.

While we recognize that the agency has many issues of great importance to deal with in these challenging times for credit unions, it is with great dismay that the message we hear from NCUA is discouragement, not encouragement, to credit unions as they seek to collaborate and work within the highly successful CUSO structure. Rather, the message we hear is that the 22 basis points of total industry assets invested in CUSOs somehow poses a systemic risk to credit unions and, as a result, NCUA needs more information about CUSOs so that NCUA can make a case to Congress to give NCUA vendor authority and ultimately the power to directly regulate CUSOs. For the reasons stated later in this letter, we do not think that NCUA has made a case that CUSOs are a systemic risk to credit unions or that the direct regulation of CUSOs by NCUA is needed or constructive.

NCUA's regulation of CUSOs, in addition to the regulation that some CUSOs already face from other regulatory bodies such as the SEC, state insurance commissions, real estate commissions, etc., will serve as a costly prohibitive factor that could well stifle the ability of CUSOs to innovate and the willingness of credit unions to invest in CUSOs within their statutory limits to do so. When regulatory considerations replace value factors in the decision to invest in a CUSO, credit unions suffer. Innovation is needed if the credit union industry is to survive and, frankly, history has proven that innovation does not blossom as splendidly under a severe regulatory environment as it does with a more balanced approach to regulation – such as currently exists with existing agencies and authorities.

NACUSO does not see that additional regulation by NCUA would provide any recognizable regulatory value beyond what already exists, especially for the aforementioned CUSOs that are already regulated by other financial services regulators (e.g., SEC and insurance regulators). We note that NCUA already has the power to inspect the books and records of CUSOs and direct the credit union owners to make changes if the CUSO is out of compliance with the CUSO Regulation or if a safety and soundness problem exists. It is our contention that NCUA's power over CUSOs and CUSO activity is already sufficient to stem serious risk issues without imposing additional burdens and the potentially chilling effect on CUSO development of a new layer of regulatory oversight.

NACUSO would also like to go on record in stating its serious concerns with NCUA's legal authority regarding the proposed amendment. NCUA does not currently have vendor authority as a result of previous temporary vendor authority not being renewed by Congress when it expired in 2001 after the Y2K crisis. While the agency recognizes in its own statements that it does not have statutory authority to regulate CUSOs, NCUA has expanded its existing reach over CUSOs through their credit union owners through this proposal by requiring CUSOs to provide financial information directly to NCUA which NCUA will retain and evaluate. This looks and feels like vendor authority and the direct regulation of CUSOs which has not been authorized by Congress. Most CUSOs and their credit union owners share this concern and fear that the legal authority for this proposal could, if finalized in its current form, could conceivably become a source of lengthy and expensive litigation for the agency (and the credit unions that fund the agency) to sustain. NACUSO does not see a compelling reason, nor empirical data provided, to justify such a far-reaching proposed rule in an area so potentially indefensible from a statutory legal authority perspective.

By imposing this level of regulatory burden upon them, CUSOs will be put at a severe competitive disadvantage with non-CUSO competitors. For example, should it enact this proposed rule as currently drafted, NCUA will be requiring CUSOs to submit their business plans, balance sheets, income statements and customer lists to the agency. Even if NCUA was given the legal authority by Congress to directly regulate CUSOs and require CUSOs to submit confidential business information to NCUA, it is obvious that the gathering and holding of this information puts a burden on CUSOs that their non-CUSO competitors will not face. Requiring these submissions seems excessive from an agency seeking only to monitor broad issues of purported systemic risk. NCUA will expose CUSOs to a marketplace disadvantage of huge proportions by exposing confidential business plans and client lists to public dissemination through FOIA requests and by virtue of the fact that NCUA is a governmental entity and makes data available to the public.

NACUSO feels that it is incumbent upon all involved in the sustainability of the credit union industry to remember that CUSOs are the most visible and oft-used collaborative arm of credit unions trying to solve operational and financial issues together. The risk sharing model that is represented by many CUSOs will be put in jeopardy if the credit unions making an investment in a needed CUSO are discouraged from doing so in order to avoid unnecessary hurdles they find placed in their path by admittedly well-intentioned, but still over-reaching, regulators as the credit unions seek solutions to their long term viability and sustainability.

Frankly, in our view, NCUA has not made a compelling case that CUSOs pose a systematic risk to credit unions that requires such a drastic and far reaching regulatory change. There has been no empirical data presented to prove that CUSOs are inefficient, performing poorly or threatening the safety and soundness of the credit union industry as a whole. Each credit union's CUSO investment risk and lending risk is less than 2% of its assets. This is a *de minimus* amount. The loss from such a small investment would, in the overwhelming majority of instances, not be material to the financial health of the credit union; however, these limits – already in place without the need for the current proposal to be laid atop them - permit credit unions the freedom to experiment and find new solutions to old problems without direct regulatory encumbrances.

As stated earlier, it is inconceivable that CUSO investment can be a true systemic risk to credit unions when the aggregate amount invested in and loaned to CUSOs is only 22 bps of total industry assets. That amount of CUSO investment is considerably less than the amount of corporate stabilization assessments in any of the past three years, yet NCUA does not consider assessments for corporate stabilization to be a cost that the industry cannot sustain. In fact, NCUA considers corporate stabilization as necessary for a stable and growing industry going forward. So are CUSOs.

Even without this new and expanded authority that goes well beyond any the agency has ever proposed in the past with its limited statutory authority over regulation of non-credit union entities, NCUA already has the ability to examine the books and records of CUSOs and exercise full leverage over the credit union owners to resolve any potential safety and soundness issues. In addition, the agency requires an extensive due diligence process for a credit union entering into a contract for services with a CUSO or investing in a CUSO. Even though there may occasionally be a specific instance in which a CUSO contributes to the safety and soundness challenges at a particular credit union, this has been the scarce exception rather than the rule over the past fifteen years during the height of CUSO development and investment by credit unions. NACUSO cannot see where NCUA has effectively made the case that CUSOs had anything to do with the current financial difficulties in the credit union industry. This "cure" seems to have been constructed in a manner that goes far beyond the "disease" outlined as its justification.

NCUA has stated two reasons for regulatory authority over all CUSOs. Both are inadequate to justify this level of new regulation. The first is that NCUA desires parity with banks' regulatory authority over bank operating subsidiaries and third party service providers, even though interestingly there is absolutely no evidence that the banks' regulatory authority over bank operating subsidiaries and third party service providers played any role whatsoever in the mitigation of the 'systemic risk' of bank losses in the economic crisis.

The second reason often cited by NCUA is a singular example. It has been stated publicly by NCUA officials that the CUSO at Texans Credit Union was a material reason why Texans Credit Union failed and that this one example, admittedly significant in this singular case, proves unequivocally that CUSOs are a systemic risk to credit unions as a whole. In the Texans situation, it must be pointed out that the regulator gave Texans expanded business lending authority beyond previously established limits, and a case could be made that ongoing supervision did not appropriately oversee the business lending activity in the credit union and, through its oversight of the credit union, demand greater accountability regarding the CUSO. Credit union examiners did not need this proposed rule to have the ability to review the CUSO's loan portfolio and take action if the CUSO's loans posed a safety and soundness issue for the credit union. If supervision failed, then supervision should be improved. However, NACUSO would submit that the current CUSO rules that have resulted in hundreds of profitable CUSOs did not fail in the Texans case. Additional rulemaking is not necessary. Even if the Texans case was symptomatic of widespread problems in CUSOs that make business loans, NCUA's attempt to use this proposal – which seems custom designed as a regulatory approach to overseeing the business lending CUSO sector - to all CUSOs is misguided. Business lending CUSOs are estimated to constitute less than 1% of total CUSOs. Again, the "cure" is out of proportion to the "disease" supposedly needing treatment.

In Chairman's Matz's testimony before Congress on June 16, 2011, in support of increasing the member business lending cap, she quoted figures from the agency that reflected the fact that out of fifty-five credit union failures in 2009 and 2010, only one was primarily related to business loans. In addition, the NCUA figures presented to Congress showed that business loans was even one of the contributing factors in only eight others failures out of the fifty-five. NACUSO, as a supporter of the congressional effort to increase the member business lending cap for credit unions, commends the Chairman's testimony on this important issue and is appreciative of her stand in support of safe and sound business lending authorities for credit unions.

The statistics Chairman Matz provided in her testimony are relevant to this proposed rule as well because they provide evidence that member business lending is largely done quite safely and soundly in credit unions. NACUSO believes that this data provided to Congress by NCUA in order to make the case that credit unions deserve more business lending authority certainly contributes to making the additional case that business lending is an appropriate function for a CUSO, many of which share the risk among multiple credit union owners. Further, these statistics seem to indicate that CUSOs in general, and business lending CUSOs in particular, are not within themselves a systemic risk to credit unions justifying such a drastic regulatory action as this proposed rule.

In addition to the aforementioned concerns, there are a number of terms in the proposed rule that give the impression that it has not been completely analyzed as to its impact and are in need of significant clarification. For, example, what is meant by a subsidiary? Does a CUSO have to have controlling interest in a company or does a 1% ownership in a company make the company a subsidiary? The informal rule has been that if there is an intent that a subsidiary of a CUSO was formed for the purpose of evading the CUSO rule, that would not be allowed. We ask that this continue to be the rule as there may be very good business reasons for a CUSO to invest in a company that is not a CUSO (e.g. more favorable pricing or access to services). Under the proposal, this viable business option would not be allowed.

Another significant question is unanswered in the proposed rule. NCUA proposes to curtail the power of credit unions with less than 6% capital to invest in CUSOs if the aggregate cash outlay to a CUSO exceeds the CUSO investment limitation on a cumulative basis. What is meant by "aggregate cash outlay on a cumulative basis"? Is this reduced by dividends received by the credit union from a CUSO investment? How far back does the cumulative calculation go? What if a credit union invested in a CUSO and has written the investment off ten years ago, does that count? How do investments in other CUSOs figure in to the analysis? What is the procedure to obtain NCUA approval to make additional investments? What are the standards of review that NCUA will use? Is there a time period in which NCUA must respond to a request or can the request go unanswered, effectively denying the request?

It is the position of NACUSO as the primary association representing the interests of CUSOs and the credit unions that invest in them that this proposed rule be withdrawn and not be enacted as a final rule. We believe firmly that, as drafted, it will choke off CUSO opportunities at a time when credit unions need them most, especially if the credit unions are less than adequately capitalized. While we understand that NCUA rightfully does not want credit unions throwing additional money into a failing CUSO, we believe that NCUA has existing authority to discover and stem these situations on grounds of safety and soundness in the limited number of cases where they may occur.

With all respect to the agency, it is important to recognize that many very successful CUSOs drive significant savings and income to credit unions but do not have a sizable capital structure or generate income. Operational CUSOs are designed to save the credit union's operating costs and not to make money. Financial service CUSOs are often formed solely for marketing or license purposes and income flows from a third party vendor directly to the credit unions. If NCUA follows the model outlined in this proposed rule to review CUSOs based solely on balance sheets and income statements, there will arise additional questions that must be answered. For example, how does NCUA expect to see the value of CUSOs to credit unions or analyze risk solely through a balance sheet or income statement? What will be the NCUA's standards of review for CUSO success? Does NCUA intend to shut down a CUSO that does not have a large balance sheet or income statement regardless of the positive financial or service impact the CUSO has for its credit union owners?

Even though it may be well intentioned and feel that such authority is crucial to its mission, NACUSO has deep concerns that NCUA is selecting specific information from CUSOs that the agency feels it needs to try to prove to Congress that CUSOs are undercapitalized and in need of regulation. Compared to credit unions, it is important to note that CUSOs have a completely separate capitalization structure and totally different needs. The vast majority of CUSOs, while they would admittedly be undercapitalized if they were credit unions, are not undercapitalized because they are, indeed, not credit unions. CUSOs are well capitalized, industry wide, to perform their specific business purpose - often which is a collaborative means to share risk, manage costs and/or market services to members.

NACUSO is also concerned about the impact this proposed rule, if enacted, would have on the staffing and operational budget of NCUA. With the wide range of activities that CUSOs are engaged in, the amount of expertise to compile, review, monitor and evaluate the multitude of business activities of CUSOs will undoubtedly require the agency to hire significant staff with a much expanded range of expertise than currently exists. This is an unnecessary agency expense that will be borne, unfortunately, by the very credit unions that may now elect not to invest in a CUSO because of this new regulatory burden and oversight. While we recognize that many of the agency's personnel increases in recent years have been more justifiable based upon the challenges facing the current financial industry, a significant increase in NCUA personnel to enforce a new CUSO rule with more questions than answers is a double hit that we feel is unfair, unjustified and unnecessary for those credit unions that will be paying the bill through their operating fees and overhead transfer from their NCUSIF.

In closing, NACUSO wants to re-state that it is philosophically committed to innovation, collaboration and return on credit union investment through the CUSO model. As an organization, we would at any time to be willing to work with NCUA to dialogue, provide our perspective and help generate a more thorough understanding of CUSO activities; however, NACUSO is opposed to any efforts – regulatory or otherwise – that will contribute to the potential killing of the goose that is laying many of the credit union golden eggs in this current challenging marketplace. That goose is representated by the CUSOs which have become what they were intended to be when they were authorized and fostered by previous NCUA Boards with leadership from both political parties - the innovative arm of the credit union industry. Let us do everything possible to keep them functioning as intended.

We truly believe if NCUA took that time to understand the positive impact CUSOs are making to credit unions under the current regulatory environment, NCUA would appreciate that any action to adversely impact CUSOs poses additional risk to the sustainability of credit unions and the share insurance fund. Before any action is taken, a thorough study of the intended and unintended consequences should be undertaken by NCUA which would involve dialogue with both CUSOs and the credit unions investing in them. NACUSO and its members are more than willing to engage in an open dialogue and information exchange with NCUA so that NCUA has more of an appreciation of the role CUSOs play and the negative impact this proposal would have on the credit union industry.

This proposal, for the reasons outlined above, will have a detrimental impact on CUSOs and the credit unions that invest in them. With all due respect and with our earlier stated offer to work in tandem with NCUA as they learn more about CUSOs in today's credit union marketplace, we strongly encourage the NCUA Board to withdraw this proposal in its entirety.

We thank you for the opportunity to comment.

Very truly yours,

Jack M. Antonini,
President of NACUSO

Cc. The Honorable Debbie Matz, Chairman
The Honorable Michael Fryzel, Board Member
The Honorable Gigi Hyland, Board Member