



Filed via: [regcomments@ncua.gov](mailto:regcomments@ncua.gov)

September 22, 2011

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

Re: Comments on Notice of Proposed Rulemaking (CUSO)

Dear Ms. Rupp:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on NCUA's proposal to expand the reporting requirements for credit union service organizations (CUSOs). By way of background, the California and Nevada Credit Union Leagues (Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members. In addition, California and Nevada are home to almost 30 CUSOs. These CUSOs provide indirect lending, ATM processing, mortgage, investment, insurance, business lending, and compliance services to credit unions and their members throughout the U.S.

## **Background**

The proposed rule would make the following changes to NCUA's CUSO regulation:

- The existing prohibition on less than "adequately capitalized" federal credit unions investing in CUSOs without obtaining prior written approval from supervisory authorities would be expanded to undercapitalized federally-insured state-chartered credit unions.
- All federally-insured state-chartered credit unions investing in or lending to a CUSO would be required to have the CUSO agree to: 1) account for all its transactions in accordance with Generally Accepted Accounting Principles; and 2) prepare quarterly financial statements and obtain an annual financial statement audit by a certified public accountant. Currently, this requirement only applies to federal credit unions.

- All CUSOs would be required to file financial reports directly with NCUA and, if a federally-insured state-chartered credit union has invested in or made loans to the CUSO, the CUSO would need to file such reports with the appropriate state supervisory authority.
- Any CUSO subsidiary would have to comply with the regulation as though it were a CUSO.
- Currently, federally-insured state-chartered credit unions could lose their National Credit Union Share Insurance Fund coverage if they do not comply with requirements in the CUSO rule regarding 1) NCUA access to their CUSO's books and records, and 2) requirements to maintain separate corporate identities from their CUSO. The proposal would expand that provision to include the requirement requiring a CUSO to agree to provide financial statements and conduct financial audits.

In the balance of our letter we will first provide our general position and concerns regarding the proposal, followed by our specific comments on each of the changes anticipated by this rulemaking.

### **The Leagues' Position**

With the exception of one provision (discussed below), the Leagues strongly oppose the proposed amendments and urge NCUA to withdraw them. While we understand that there have been some problems in a small number of CUSOs and their credit union owners, these problems have generally stemmed from a combination of poor economic factors, excessive lending concentrations, and/or lack of adequate and timely use of existing supervisory oversight authority. Such isolated incidents do not warrant NCUA's claim that CUSOs constitute a systemic risk within the credit union industry. In fact, only 28 percent of the 7,386 credit union in the U.S. report an investment in a CUSO. Of those, only 30 credit unions indicate a CUSO investment greater than two percent of assets. Put another way, 7,356 credit unions—or 99 percent—have either no investment in a CUSO, or less than a two percent of assets investment. At \$1.3 billion, the total amount of credit union investment in CUSOs is only 14 basis points of total credit union assets. In our view, it stretches the limits of plausibility to suggest that such a level of investment in CUSOs poses systemic risk to the industry.

Further, we do not believe NCUA has the statutory authority to examine CUSOs in the manner provided in the proposal. Bank and thrift service organizations are subject to examination by the appropriate federal banking agency pursuant to the Bank Service

Company Act, but NCUA has not had similar statutory authority to fully examine CUSOs since 2001, when its temporary CUSO examination authorities were not renewed by Congress after Year 2000 conversion. The Leagues opposed NCUA's 2008 expansion of oversight of CUSOs held by federally-insured, state-chartered credit unions on the grounds that NCUA was exceeding its statutory authority. This proposal goes even further, moving NCUA ever closer to direct examination and regulation of CUSOs. This has not been authorized by Congress.

Rather than impose additional regulatory authority over all CUSOs, it makes much more sense for NCUA to utilize its existing authority in cases where individual CUSOs activities or credit union CUSO investment levels warrant concern. We believe that NCUA already has adequate authority to manage and mitigate any risks posed to the share insurance fund by CUSOs. This includes its broad authority to stop credit union actions to resolve any safety and soundness issues, as well as its authority to order credit unions to divest themselves of ownership of a CUSO and to discontinue doing business with any vendor, including CUSOs. Further, pursuant to §712.3(d)(3) of its Rules and Regulations, NCUA currently has the authority to examine the books and records of CUSOs. Current NCUA CUSO regulations also require credit unions to obtain a legal opinion prior to the credit union investing in, or lending money to, a CUSO to ensure the CUSO is established in a manner that will limit the credit union's exposure to no more than the amount invested. This is in addition to NCUA's vendor due diligence requirements, which are applicable to CUSOs as well as third party vendors. These existing requirements already provide adequate means to address NCUA's concern regarding the risk of piercing of corporate and LLC veils, and to effectively mitigate the relatively minimal investments that credit unions have in CUSOs.

CUSOs are an important source of non-interest income for their credit union investors. This is especially critical in today's environment, as credit unions cannot survive and thrive solely from net interest margin. Through collaboration and harnessing of "systemic opportunities," CUSOs offer credit unions the ability to improve net income, to take advantage of innovation, and to share risks. The proposed changes would deal a severe blow to all of these critical benefits.

The costly, unnecessary, and burdensome reporting and audit requirements will hinder the ability of CUSOs to continue to innovate and provide cost-effective products and services. If CUSOs are regulated differently from other vendors (i.e., their competitors) they will be placed at a competitive disadvantage, which will curtail the impact they have in the marketplace of keeping a competitor's pricing lower for the industry.

## **Additional Comments on Proposed Changes**

### Undercapitalized Credit Unions' Participation in CUSOs

Currently, federal credit unions that are less than adequately capitalized may not invest in a CUSO if the investment would require a total cash outlay of more than one percent of the credit union's paid in and unimpaired capital and surplus, unless the credit union receives prior written approval from its NCUA regional director. The proposal would apply this general requirement to undercapitalized federally-insured state-chartered credit unions, which would have to obtain approval from their state regulator and notify NCUA of the request for approval. The Leagues believe that this requirement is consistent with safety and soundness concerns, and is reasonable since federal credit unions are already subject to it.

### CUSO's Owned by Federally-Insured State Credit Unions—Accounting and Financial Statements

All federally-insured state-chartered credit unions investing in or lending to a CUSO would be required to have the CUSO agree to: 1) account for all its transactions in accordance with Generally Accepted Accounting Principles; and 2) prepare quarterly financial statements and obtain an annual financial statement audit by a certified public accountant. Currently, this requirement only applies to federal credit unions.

While we understand the appeal of consistency in applying this requirement to federally-insured state-chartered credit unions, we believe that it is an ill-timed and unnecessarily costly step to take right now. Keeping in mind that costs borne by a CUSO ultimately affect their credit union owners, we ask NCUA to consider the following example shared with us by a federally-insured state-chartered credit union of the costs the proposal would impose on its CUSO:

*Our CUSO will have approximately \$200,000 of net income this year. Costs for an audit of our CUSO financial statements could run upwards of \$30,000, which is more than 15 percent of our net income. In addition, staff time to respond to audit requests and requests by the NCUA will be burdensome. Our CUSO currently has 10 employees. Each employee is at full capacity with their workload and responding to audit requests would put increased pressure on them. Hiring an additional employee to serve this purpose is cost prohibitive as our costs could be near \$50,000 including taxes and benefits. Coupled with the audit costs, our net income would now be only \$120,000, a reduction of 40% due to increased regulatory oversight.*

Clearly, it would be unwise and unfair to subject CUSOs—and their credit union owners—to such significant new costs during these still-fragile economic times. Regulatory compliance burdens and costs continue to challenge CUSOs and credit unions, and show little sign of easing in the near future. The Leagues do not support imposing still more direct and indirect costs, compliance burdens, and uncertainty on federally-insured state-chartered credit unions at this time.

#### Access to Information from the CUSO by Regulators

Under the proposal, all CUSOs would be required to file financial reports directly with NCUA and, if a federally-insured state-chartered credit union has invested in or made loans to the CUSO, the CUSO would need to file such reports with the appropriate state supervisory authority. As stated earlier, the Leagues opposed NCUA's 2008 requirement that credit unions must obtain an agreement with their CUSO to provide access to its books to NCUA. We did so on the grounds that it was outside NCUA's legal authority to do so. Likewise, we oppose the proposed requirements on the same grounds.

We have already touched on the distinct competitive disadvantage that CUSOs will face in the marketplace if subjected to the proposed changes. However, these concerns go deeper than the factors discussed earlier. Under the proposal, CUSOs would be required to submit their balance sheets, income statements, and confidential business plans and customer lists to NCUA. These documents comprise a corporation's intellectual property, and could potentially expose private business secrets to public dissemination through Freedom of Information Act requests. Such risks would not be faced by CUSO competitors and could, in fact, be exploited by them. This would be of substantial concern even as a standalone issue; unfortunately, it joins the list as one of many unnecessary, burdensome, and unintended consequences of the proposed changes.

A number of questions are raised in the proposal, yet left unanswered, regarding NCUA's intention to use balance sheets and income statements to review CUSOs. 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? Will those standards vary depending on the nature of the CUSO's business activities? 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 on its credit union owners? Such an approach would be problematic, as CUSOs are generally designed to be operated at the lowest possible cost for the purpose of maximizing credit union value. In our view, these unaddressed questions indicate that little thought has been given to the purpose, operation, and effects of the proposal beyond the narrow focus of perceived "systemic risk."

In addition, the issue of reviewing a CUSO's financial reports immediately raises the question: from where at NCUA will come the staff, expertise, and other resources need to compile, review, monitor, and evaluate the multitude of business activities that CUSOs engage in? It would seem that significantly more staff with knowledge of the lines of business that each CUSO represents would have to be added. It is our opinion that such a substantial investment to enforce a CUSO rule is an unjustified and unnecessary expense on the CUSO industry and, subsequently, on credit union owners. The Leagues submit that NCUA's efforts and resources would be more effective in addressing industry risk if they were directed at the agencies' current efforts to educate and hold accountable credit union management on service provider policies and due diligence, including selection, management, monitoring and risk mitigation activities.

#### Subsidiary CUSOs

The proposal would require any CUSO subsidiary to comply with the regulation as though it were a CUSO. CUSOs subsidiaries funded by CUSOs that receive investments or loans from state credit unions would have to also meet state requirements. As with the proposed changes affecting non-subsubsidiary CUSOs, the Leagues believe that NCUA's authority for these provisions is questionable, and therefore oppose them.

#### Tying CUSO Rule Compliance to Conditions for NCUSIF Coverage

The proposal would condition National Credit Union Share Insurance Fund coverage on a credit union's CUSO agreeing to provide financial statements and conduct financial audits as required under the CUSO regulation. As stated earlier, we believe that NCUA already has adequate authority to manage and mitigate any risks posed to the share insurance fund by CUSOs. Such regulatory heavy-handedness is unfounded, unfair, and punitive. The Leagues staunchly oppose this requirement.

#### Paperwork Reduction Act Analysis

We are concerned that while NCUA's Paperwork Reduction Act analysis provides paperwork-related regulatory burden estimates for credit unions, it does not provide estimates of the proposal's regulatory burden on CUSOs. Since CUSOs face significant new costs under the proposal, and costs incurred by a CUSO ultimately reach their credit union owners, leaving out the regulatory burden on CUSOs seriously underestimates the significant economic impact that this proposal will actually have on credit unions. Such a lack of key analysis highlights the proposal's tenuous rationale and poorly thought out effects, and serves to underscore our opposition to it.

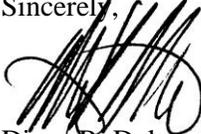
Recommended Change to Current Regulation

Finally, while we urge NCUA to withdraw this rulemaking, we believe that a clarification should be made in the current CUSO regulation. Specifically, we ask NCUA to make a distinction with regard to the risk of piercing the corporate veil of a CUSO wholly owned by a single credit union versus a CUSO owned by multiple credit unions. For CUSOs with many shareholders, it is unlikely that a court would find the type of circumstances present that would warrant piercing its corporate veil. Where such a risk does not exist as a matter of fact or law, there is no justification for regulatory action. We believe NCUA should define and distinguish multi-credit union-owned entities and exempt them from regulatory burdens directed at single credit union-owned entities, (i.e. true subsidiaries).

In closing, the Leagues ask NCUA to carefully consider the very real benefits CUSOs provide, and to thoughtfully assess the very real, and negative, impact these changes will have on CUSOs and the credit unions that depend on them for innovative, cost effective solutions. We do not believe it is unreasonable for NCUA as a safety and soundness regulator to consider whether additional rules are required to address current or potential problems. However, the proposed rule is unreasonable and inappropriate, and is not based in authority under the Federal Credit Union Act.

Thank you for the opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read "Diana R. Dykstra", written over a circular stamp or seal.

Diana R. Dykstra  
President/CEO