

**Illinois Credit Union League**

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***VIA E-MAIL TRANSMISSION***  
***regcomments@ncua.gov***

September 26, 2011

Ms. Mary Rupp,  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, Virginia 22314-3428

Re: Comments on Notice of Proposed Rulemaking (CUSO),  
12 C.F.R. Parts 712 and 741, 76 FR 44866, July 27, 2011

Dear Ms. Rupp:

The Illinois Credit Union League represents over 375 federal credit unions (FCUs) and federally insured state chartered credit unions (FISCUs) in Illinois that, in turn, serve approximately 3,000,000 Illinois consumers. The League also owns ICUL Service Corporation, a credit union service organization that provides credit, debit, pre-paid debit, and ATM services to credit unions in 47 states. We are pleased to comment on the proposed amendments by the National Credit Union Administration (NCUA) to its credit union service organization (CUSO) regulation.

The NCUA states that the purpose of the amendments is to “address certain safety and soundness concerns” by--

- making additional provisions of the current CUSO regulation applicable to FISCUs;
- imposing investment limits on FISCUs that are less than adequately capitalized;
- adding requirements related to accounting and reporting by CUSOs owned by FISCUs;
- requiring CUSOs to file financial reports directly with the NCUA and the appropriate state supervisory authority; and
- requiring subsidiary CUSOs to “follow all applicable laws and regulations.”

We oppose the proposed amendments as issued and believe the proposal should be withdrawn or modified to substantially restrict its scope for the reasons set forth below.

## **General Concerns**

### Deleterious Effect on CUSO Operations

CUSOs have served as an important means for credit unions to meet their members' financial needs and offer innovative products. Some CUSOs offer programs enabling smaller credit unions to offer needed products to their members, such as debit and credit cards that such credit unions would otherwise be unable to provide. Many credit unions have substantially improved their net income through income and savings generated by their relationship with one or more CUSOs. We are concerned that the effect of the proposed amendments will impede the operations of CUSOs, impose unnecessary additional expenses, and stifle product innovation.

### The Proposed Amendments Exceed NCUA's Regulatory Authority

The NCUA has not provided any information regarding its safety and soundness concerns, or provided any analysis or data to justify the very substantial increase in the regulation of CUSOs that would occur if the proposed amendments are adopted. In addition, as discussed below, we believe that NCUA lacks the legal basis to impose most of the proposed amendments. We are compelled therefore oppose the rule as drafted.

We understand that total investment by credit unions in CUSOs is approximately 0.22% of total credit unions assets. Given the relatively minuscule amount invested and the lack of any substantial loss from such investments, we must conclude that CUSOs pose a minimal risk to the NCUSIF and that the NCUA's assertion of safety and soundness concerns is without merit.

There is no statutory authority in the Federal Credit Union Act (FCU Act) for regulation of CUSOs by the NCUA. However, a review of the proposed additional restrictions and information gathering requirements listed on the first page of this letter indicates that the NCUA is, in fact, attempting to directly regulate CUSOs.

Congress did previously amend the FCU Act to provide the NCUA authority to examine CUSOs in connection with Y2K concerns but intentionally allowed those amendments to expire in December 2001. This was a clear indication that Congress did not intend the NCUA to regulate CUSOs directly. In light of the removal of examination authority by Congress, we believe there is less than substantial authority for the provisions in §712.3 of the current rule that require a CUSO to provide the NCUA complete access to its books and records and for "review" of the CUSO's internal controls (which in our experience is in actuality an examination that goes well beyond reviewing internal

controls). We also believe there is absolutely no support in the FCU Act for the proposed requirement to allow the NCUA to require direct annual reporting by CUSOs to the NCUA.

Given the lack of evidence of any material threat posed by CUSOs to the safety and soundness of the NCUSIF, some commenters have suggested that the information gathering contained in the proposed rule is a prologue to the NCUA seeking an amendment to the FCU Act to explicitly authorize NCUA regulation of CUSOs.

The only provisions regarding CUSOs in the FCU Act is the authority for a federal credit union to invest in or lend to a CUSO and a restriction on the amount that may invested or loaned. We have previously brought to the NCUA's attention the Constitutional parameters set forth in the United States Supreme Court's decision in *Chevron v. Natural Resource Defense Council*, regarding the standard by which actions of an administrative agency are governed.<sup>1</sup> The constitutional validity of an agency action is determined by a two-step analysis.

It must first be determined whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, the court, as well as the agency, "must give effect to the unambiguously expressed intent of Congress."<sup>2</sup> We believe there is a compelling argument that the specific removal in 2001 of the statutory authorization for the NCUA to examine CUSOs should be considered the clear intent of Congress that the NCUA is not empowered to examine CUSOs (even if the NCUA does refer to the examination as a "review").

If it is determined that Congress has not specified unambiguous intent as to the meaning of a statute, an agency may interject additional construction through rulemaking but is not allowed unfettered discretion to promulgate any rules or regulations it sees fit under the guise of a chosen statute.

- If Congress explicitly left a gap for intentional rulemaking, such rules cannot be "arbitrary, capricious, or manifestly contrary to the statute."<sup>3</sup>
- Should no explicit "gap" exist and delegation to an agency to promulgate appropriate rules is implied, those rules must be executed under a reasonableness standard.

Congress did not explicitly leave a gap with respect to the CUSO provisions of the FCU Act and therefore the reasonableness standard would apply to any proposed CUSO rules.

Under certain conditions, *Chevron* operates as a deferential standard, reducing judicial interference in agency actions.<sup>4</sup> It is imperative to note, however, that the Supreme Court

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<sup>1</sup> *Chevron v. Natural Resource Defense Council*. 467 U.S. 837 (1984).

<sup>2</sup> *Id.* at 842-843.

<sup>3</sup> *Id.* at 844.

<sup>4</sup> *Chevron* at 844.

has unequivocally stated that deference does not give an agency carte blanche when it comes to rulemaking and it will not tolerate expanding the authority of a certain statute to “virtually any [agency] interpretation.”<sup>5</sup> The expansion of authority contained in the proposed amendments to the CUSO rule without any justification by the NCUA other than a vague reference to safety and soundness is an expansion that would not be countenanced by a reviewing Court (particularly given the small amount invested in CUSOs and no evidence provided by the NCUA that there are systematic concerns with CUSOs).

#### Contradictory Statements Regarding CUSO Regulatory Oversight and Enforcement

In light of the NCUA’s determination to seek a substantial increase in its CUSO oversight and enforcement authority, it is interesting to review the NCUA’s emphatic denial that it had such authority in the Supplementary Information accompanying the July 28, 2010 promulgation of the SAFE Act’s mortgage loan originator (MLO) registration procedures.

In the Supplementary Information accompanying the 2010 final MLO Registration rule, NCUA explained that unlike the MLOs employed by bank subsidiaries, MLOs employed by CUSOs, could not be allowed to register in lieu of obtaining a license because in the case of CUSOs “NCUA does not have direct regulatory oversight or enforcement authority. Instead, NCUA regulation permits Federal credit unions to invest in or lend only to CUSOs that conform to the limits specified in the CUSO rule.” The 2010 Supplementary information also contained the statement that NCUA regulations did not have any applicability to CUSOs owned by State-chartered credit unions.<sup>6</sup>

By contrast, in the Supplementary Information accompanying the 2011 proposed CUSO amendments the NCUA states, “it is imperative to have complete and accurate financial information about CUSOs and the nature of their services to ensure protection of the NCUSIF and to identify emerging systematic risk posed by CUSOs within the credit union industry.”<sup>7</sup>

The statement in the current proposed rulemaking regarding NCUA’s imperative need for complete and accurate financial information about CUSOs and the nature of their services certainly appears to indicate a desire to have “direct regulatory oversight.” It is also clear that the proposed amendment to §741.222 to make compliance with the proposed CUSO requirements a condition for NCUSIF coverage constitutes “direct enforcement authority” (given the implicit threat that involvement in a non compliant CUSO could result in loss of NCUSIF coverage).<sup>8</sup>

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<sup>5</sup> *Cuomo v. Clearing House Ass'n, L.L.C.* 129 S.Ct. 2710, 2715 (U.S. 2009).

<sup>6</sup> 75 FR 44684 (July 28, 2010) reprinted to correct foot note numbering in 75 FR 51623 (August 23, 2010).

<sup>7</sup> 76 FR 44866 (July 27, 2011)

<sup>8</sup> Of course, through NCUA Rule 708b Subpart B, NCUA also controls the process by which a credit union may convert to private share insurance in the States that permit a private insurance option.

Applicability to CUSOs Owned by FISCUs. The NCUA's asserts in the July 28, 2010 *Federal Register* that the CUSO rule had no applicability to CUSOs owned by FISCUs. However the NCUA had in fact, previously amended Part 741—"Requirements for Insurance" in 2008 to require FISCUs to adhere to the requirements in §712.3(d)(3) and §712.4 of the CUSO rule.<sup>9</sup>

While the authors of the 2010 Supplementary Information on MLO Registration were apparently not aware of the 2008 amendments, the authors of the 2011 CUSO Supplementary Information state, "[i]n 2008, the NCUA Board issued a final rule, which among other things made certain provisions of the CUSO regulation applicable to FISCUs."

It is disappointing that in 2010 NCUA denied having any regulatory oversight and enforcement authority over CUSOs in a situation where such authority would have lightened the burden on CUSOs, but now wishes to impose additional oversight and enforcement authority that will increase CUSOs expenses and otherwise reduce their ability to serve credit unions. Regulatory hostility and bias towards CUSOs is contrary to the interests of credit unions and the members they serve.

#### Budgetary Issues

In this period of economic malaise, credit unions continue to face substantial profitability issues. Additional regulation and examination of CUSOs and gathering and analysis of data and information on CUSOs by NCUA will doubtless result in additional costs to the NCUSIF that will ultimately be borne by credit unions.

If the NCUA believes it has legitimate concerns about a credit union's relationship with a CUSO, the appropriate approach is to review the credit union's adherence to the NCUA's vendor due diligence regulatory guidance provided in NCUA 2007 Letter to Federally Insured Credit Unions 07-CU-03 (guidance supplemented and expanded by additional NCUA letters to credit unions each year thereafter).

#### **Specific Comments**

##### Proposed Amendment of §712.2(d)(3), "Special Rule in the Case of Less than Adequately Capitalized Credit Unions"

The proposed revision to §712.2(d)(3) would apply to a FISCU classified as less than adequately capitalized as determined pursuant to 12 C.F.R. Part 702 or where the making of an investment in a CUSO would render the FISCU less than adequately capitalized under Part 702. The FISCU would be required to obtain approval of the FISCU's state regulator prior to making an investment in a CUSO if the investment would result in an aggregate cash outlay on a cumulative basis in an amount in excess of the CUSO investment limit in the state in which it is chartered. The current rule imposes a similar standard on FCUs.

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<sup>9</sup> 73 FR 79307 (December 29, 2008)

ICUL does not oppose this provision. It addresses application of statutory CUSO investment limits and is consistent with safety and soundness.

We suggest the following revisions to proposed §712.2(d)(3).

- The proposed amendment should specify a reasonable time frame for the NCUA or state regulator to notify a credit union whether the request has been approved.
- The proposed amendment requires a FISCU to submit a copy of the request for approval to the appropriate NCUA Regional Office. The Supplementary Information makes it clear that the state regulator makes the determination and the submittal to the NCUA is for information purposes. We believe it would helpful to specify in the regulation that the submittal to the NCUA is solely for information purposes.
- There should also be a provision authorizing FCUs to appeal a decision of an NCUA Regional Office.

#### 12 C.F.R. §712.3, Access to Information from the CUSO by Regulators

We strongly oppose the imposition of direct reporting by CUSOs to the NCUA and the state regulators. As indicated in our general comments, we believe imposition of annual direct reporting would be considered direct oversight of CUSOs by the NCUA and, as stated by the NCUA in its MLO registration comments, direct oversight of CUSOs is not within its authority. Sections 712.3 and 741.222 of the current rule require CUSOs to provide the NCUA and state regulators with complete access to any books and records of the CUSO and the NCUA has not provided credible justification of the need for direct reporting.

With respect to the information that would be required in the annual report, credit unions and their CUSOs are very concerned about the requirement that the annual report include a list of the CUSO's customers. Their major concerns regarding the customer lists involve privacy issues and the danger that a CUSO may be put competitive disadvantage if the customer information ends up in the hands of its competitors. We cannot envision any safety and soundness basis for requiring this information. If the NCUA does adopt direct reporting, this requirement should be deleted.

#### 12 C.F.R. §712.10, Exemption Authority for State Regulators

The current regulation authorizes the NCUA Board to exempt FISCUs in a specific state from compliance with §712.3(d)(3) of the Rule if the NCUA determines that the laws and procedures available to the FISCU's state regulator provide the NCUA with the degree of access and information it "believes is necessary to evaluate the safety and soundness of credit unions having business relationships with CUSOs owned by credit union(s) chartered in that state." The proposed amendment would also exempt such FISCUs from compliance with §712.3(d)(1) and (2).

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However the remainder of the current and proposed rule makes it clear that the exemption is of no value, since the state regulator must provide the NCUA with assurance that NCUA examiners will be provided with co-extensive authority and allowed direct access to the books and records of the CUSO “at such times as NCUA, in its sole discretion may determine necessary or appropriate.” In addition, the requirements contained in current and proposed §712.10(b) for documentation from the state regulator requesting the exemption--“all procedural and operational documentation supporting and describing the actual practices by which it [the state regulator] implements and exercises the authority”-- appears to indicate that the NCUA has little faith in the regulatory ability of FISCO’s state regulators.

12 C.F.R. §712.11, Subsidiary CUSOs

Proposed new §712.11 would subject “subsidiary CUSOs” to all of the requirements of the NCUA CUSO regulation. We believe the NCUA’s legal basis for imposing this requirement is extremely tenuous and NCUA has not provided any meaningful justification for the proposal.

In addition, the NCUA has included a definition of a “subsidiary CUSO” for purposes of §712.11 as “any entity in which a CUSO invests.” CUSOs are authorized by §712.5(r) to invest in non-CUSO service providers in connection with providing a permissible service. We believe such non-CUSO service providers would oppose compliance with the NCUA’s CUSO rule, since the agency has no statutory basis of authority over them. We assume the NCUA did not intend to include non-CUSO providers in its definition of subordinate CUSOs.

We appreciate the opportunity to respond to the NCUA’s request for comment on the proposed amendments to the CUSO rule. We and the credit unions we serve strongly oppose the implementation of this proposal. The proposal would implement direct CUSO oversight and enforcement authority by the NCUA and the NCUA lacks a legal and constitutional basis to directly regulate CUSOs. The NCUA has provided no meaningful evidence that a regulation is necessary and we believe the agency already has sufficient supervisory tools to address issues that could negatively affect the safety and soundness of credit unions or the NCUSIF. We will be happy to respond to any questions regarding these comments.

Very truly yours,

ILLINOIS CREDIT UNION LEAGUE

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