

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Parts 712 and 741**

**RIN 3133-AD93**

**Credit Union Service Organizations**

**AGENCY:** National Credit Union Administration (NCUA)

**ACTION:** Proposed rule.

**SUMMARY:** NCUA proposes to amend its credit union service organization (CUSO) regulation to address certain safety and soundness concerns. Specifically, this proposal expands the requirements of the CUSO regulation that apply to federally insured state-chartered credit unions (FISCUs) to include investment limits for FISCUs that are “less than adequately capitalized” and requirements related to accounting and reporting by CUSOs owned by FISCUs. This proposal also adds two new requirements that would apply to both federal credit unions (FCUs) and FISCUs. These new items would include requiring CUSOs to file financial reports directly with NCUA and the appropriate state supervisory authority and requiring subsidiary CUSOs to follow all

applicable laws and regulations. Finally, this proposal makes conforming amendments to NCUA's regulation on the requirements for insurance to address the items discussed above that apply to FISCUs.

**DATES:** Comments must be received on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments by any of the following methods (**Please send comments by one method only**):

- NCUA Web Site:  
[http://www.ncua.gov/news/proposed\\_regs/proposed\\_regs.html](http://www.ncua.gov/news/proposed_regs/proposed_regs.html). Follow the instructions for submitting comments.
- E-mail: Address to [regcomments@ncua.gov](mailto:regcomments@ncua.gov). Include “[Your name] Comments on Notice of Proposed Rulemaking (CUSO)” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

**FOR FURTHER INFORMATION CONTACT:** Justin M. Anderson, Trial Attorney, Pamela Yu, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540 or Lisa Dolin, Program Officer, Office of Examination and Insurance, at the above address or telephone at 703-518-6630.

## **SUPPLEMENTARY INFORMATION.**

### **A. Background.**

In 2008, the NCUA Board (the Board) issued a final rule, which, among other things, made certain provisions of the CUSO regulation applicable to FISCUs. 73 FR 79312 (December 29, 2008). Specifically, the final rule required FISCUs to maintain separate corporate identities with their CUSOs and enter into agreements with CUSOs stating that the CUSOs would provide open access to their books and records to NCUA and the applicable state supervisory authority (SSA). *Id.* Those provisions had previously only applied to FCUs, but the Board believed that, to protect the National Credit Union Share Insurance Fund (NCUSIF), it was necessary to make those requirements applicable to FISCUs as well. Since the promulgation of the 2008 rule, the Board has continued to investigate ways to gather complete and accurate information about credit unions' use of CUSOs and the services those entities provide. As a result, the Board is proposing this rule, which as discussed below, makes additional parts of the CUSO rule applicable to FISCUs, requires CUSOs to file financial reports directly to NCUA and the appropriate SSA, and addresses subsidiary CUSOs.

### **B. Proposal**

The Board believes additional protections in the CUSO rule, currently only applicable to FCUs, addressing accounting, financial statements, and audits should apply to FISCUs as well to protect credit unions and the NCUSIF.

The Board also believes 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 systemic risk posed by CUSOs within the credit union industry. At this time, the Board, through agreements between credit unions and CUSOs, maintains the right to inspect the books and records of CUSOs. This, however, does not provide NCUA with complete information necessary to evaluate CUSOs and their potential impact to the NCUSIF. As such, the Board is proposing to require both FISCUs and FCUs to include, in their agreements with CUSOs, a requirement that a CUSO submit a financial report directly to NCUA and the appropriate SSA, in the case of a FISCU, at least annually. As discussed below, NCUA will issue guidance on the required specific timing of and information contained in these reports.

The Board is also concerned that “less than adequately capitalized” FISCUs that continue to invest money in a failing CUSO pose serious risks to their members and the NCUSIF. Accordingly, the Board is proposing to subject FISCUs to a similar requirement contained in current §712.2(d)(3) for FCUs. Specifically, the proposal limits a “less than adequately capitalized” FISCU’s aggregate cash outlay to a CUSO, measured on a cumulative basis, to the permissible investment limit in the state in which the FISCU is chartered.

Finally, the Board wants to ensure that all requirements in the CUSO rule also apply to subsidiary CUSOs. For consistency, the Board is proposing to prohibit FCUs and

FISCUs from investing in a CUSO unless that CUSO's subsidiaries also comply with all of the requirements of the CUSO rule and/or laws and rules of the state in which the credit union is chartered, as applicable.

### **C. Section by Section Analysis**

#### *1. 741.222 Requirements for insurance – Credit union service organizations.*

Subpart B of Part 741 addresses NCUA regulations that FISCUs must follow to obtain and maintain federal insurance from NCUA. The specific section of part 741 amended by this proposal lists those portions of the CUSO regulation that FISCUs must follow as a condition of federal insurance. Currently, only two provisions of the CUSO rule apply to FISCUs: the requirements to maintain separate corporate identities with their CUSOs and enter into agreements with CUSOs stating that the CUSOs will provide open access to their books and records to NCUA and the applicable SSA.

However, the Board believes to protect the NCUSIF it is appropriate and necessary to make additional sections applicable to FISCUs. As noted in the 2008 proposed rule, while NCUA has the authority under the Federal Credit Union Act to impose regulatory requirements on FISCUs, NCUA's approach has always been to work cooperatively with the SSAs and only regulate where there are safety and soundness concerns. 73 FR 23983 (May 1, 2008).

In keeping with that approach, and for the reasons noted below, the Board is proposing to amend §741.222 of NCUA's regulations to specify that current §§ 712.2(d)(3), 712.3(d), 712.4 and new §712.11 apply to FISCUs (as well as FCUs). Each of these sections is discussed more fully below.

In accordance with the proposed change regarding subsidiary CUSOs, the Board is also proposing to expand the definition of a CUSO to include subsidiary CUSOs. As discussed below, a subsidiary CUSO is any entity in which a CUSO invests. The definition of a subsidiary CUSO, however, does not extend to outside third parties a CUSO contracts or otherwise does business with, but is limited only to those entities in which the CUSO has made an investment.

## *2. §712.1 What does this part cover?*

The Board proposes to update this section of the CUSO regulation by creating three subsections, which retain most of the language from the current section but also address the changes made in this proposal. The first subsection will retain most of the current language in §712.1 and state that Part 712 addresses FCUs making loans and investments in CUSOs but does not apply to corporate credit unions that have CUSOs subject to §704.11.

The second subsection addresses those sections of the regulation that apply to FCUs as well as FISCUs and reflects the proposed changes in this rule as well as those

sections that currently apply to FISCUs. Specifically, this subsection would identify §§712.2(d)(3), 712.3(d), 712.4 and 712.11 as those sections of the CUSO rule that apply to both FCUs and FISCUs. In addition, this new subsection contains a clarification that a FISCU must comply with the law in the state in which it is chartered with respect to any activity that is not regulated by NCUA. The Board believes that this statement will provide FISCUs with a better understanding of the interplay between federal and state laws and when each system applies to a particular activity.

The third subsection added by this proposal would provide that the term “federally insured credit union” or “FICU” means all FCUs and FISCUs . The Board believes this additional definition will add conciseness to the rule and is more favorable than repeating the phrase “FCU and FISCU” throughout the sections of the CUSO regulation that apply to both. In conjunction with this change, the Board also proposes to make modifications to those sections that apply to both FCUs and FISCUs to use the term “FICU” where applicable. The Board believes the new structure of this section proposed by this rule will add clarity to the regulation, eliminate confusion, and be more user friendly.

3. *§712.2 How much can an FCU invest in or loan to CUSOs, and what parties may participate?*

In the 2008 final rule amending the CUSO regulation, the Board approved an addition to the regulation that required less than adequately capitalized FCUs to obtain written

approval from the appropriate regional director before making an investment in a CUSO that would result in an aggregate cash outlay, measured on a cumulative basis, in an amount in excess of one percent of the credit union's paid in and unimpaired capital and surplus. 73 FR 79312 (December 29, 2008). In the 2008 proposed rule, the Board noted it was aware of credit unions that had experienced losses because they chose to recapitalize insolvent CUSOs.

As noted above, this proposed rule adds a similar requirement for FISCUs that are or would become less than adequately capitalized. Specifically, this proposed change would require a FISCU to obtain written approval from the appropriate SSA before making an investment that would result in an aggregate cash outlay, measured on a cumulative basis, that exceeds the investment limit in the state in which the FISCU is chartered, if the FISCU is less than adequately capitalized or the investment would result in the FISCU being less than adequately capitalized. In addition to submitting a request to the appropriate SSA, under this proposal, a less than adequately capitalized FISCU must also submit its request to the appropriate NCUA Regional Office. While the SSA will render decisions on such requests, the Board believes it is important that NCUA's Regional Offices also be made aware of these requests so these offices can provide appropriate input to the SSAs.

This amendment would minimize the likelihood that a FISCU may be investing in a CUSO, on an aggregate basis, more than the limit imposed in the state in which it is chartered and would eliminate the possibility of a FISCU becoming under capitalized



because of its investment in a CUSO. This amendment would also prevent a FISCU from continuing to invest in an entity that has become unsustainable. As noted above, the limit for FISCUs would be the investment limit in the state in which the credit union is chartered. If the state does not regulate the investment limit for FISCUs, however, the 1% limit applicable to FCUs will apply. The Board notes that this amendment would not require a less than adequately capitalized FISCU to divest in a CUSO. Rather, a less than adequately capitalized FISCU may maintain its existing investment but cannot make additional investments without prior written concurrence from the appropriate SSA.

4. *§712.3 What are the characteristics of and what requirements apply to CUSOs?*

The Board is proposing to expand the scope of subsection (d) of this section to apply to FISCUs as well as FCUs. As noted above, in 2008 the Board approved final amendments to this section that required FISCUs to comply with the requirements addressing access to a CUSO's books and records. 73 FR 79312 (December 29, 2008). The Board noted in 2008 that FISCUs are exposed to significant potential safety and soundness and reputation risks based on their relationships with CUSOs. While NCUA currently has the ability to examine the books and records of a CUSO owned by a FISCU, this does not allow the agency to gather all of the information necessary to ensure a uniform system of monitoring and evaluation of the financial condition of CUSOs invested in or loaned to by FISCUs. As such the Board is proposing to have the remaining subsections of §712.3(d) also apply to FISCUs. These

remaining subsections necessitate a credit union's agreement with a CUSO to require the CUSO to account for all of its transactions according to Generally Accepted Accounting Principles (GAAP), prepare quarterly financial statements, and obtain an annual financial statement audit of its financial statements by a licensed certified public accountant. These requirements will ensure NCUA will be able to clearly and uniformly review the financial condition of CUSOs and evaluate the risks posed to FISCUs and the NCUSIF. While these requirements will greatly increase the ability and efficiency of NCUA's monitoring of CUSOs, as discussed below, these requirements do not provide all of the information necessary to adequately evaluate CUSOs. As such, the Board is also proposing a new subsection that states that an FCU's or FISCU's written agreement with its CUSO further requires the CUSO to submit financial reports directly to NCUA and, in the case of a CUSO invested in by a FISCU, NCUA and the appropriate SSA.

Currently, the information NCUA has been able to compile on CUSOs is incomplete and flawed, as the agency is attempting to gather pertinent information from customer credit unions rather than directly from the CUSO. The Board notes that without further reporting directly from CUSOs, it is impossible for NCUA to determine which CUSOs maintain relationships with credit unions, the financial condition of CUSOs, and the full range of service those entities are offering. This lack of information restricts NCUA's ability to conduct offsite monitoring and evaluate the systemic risks posed by CUSOs. This new requirement will allow NCUA to collect uniform information directly from all CUSOs, which will allow the agency to adequately evaluate the relationships between

CUSOs and credit unions and the systemic risk posed by those relationships. As discussed below, the information required in the reports will be comprehensive to allow NCUA to obtain a clear picture of, not only relationships between CUSOs and credit unions, but also the structure of CUSOs, the services they offer, and their financial condition.

The reporting addressed in this proposed new subsection will be required at least annually and will address five broad categories, which are summarized in the following table:

<b>Category</b>	<b>Examples of required information</b>
General Information	EIN of CUSO, state of incorporation, date of incorporation, date of most recent audit, subsidiary information, disaster recovery plans and testing, and headquarters and branch locations.
Board and Management	Contact information for each board member, affiliated credit union, and their position at their credit union.
Services	List of services offered.
Customer Listing	List of clients by charter number, name, service, and level of activity.
Balance Sheet and Income Statement	Balance sheet, income statement, capital structure by credit union and amount, unfunded commitments, contingent liabilities, borrowings, investments, audits, and loan activity.

While the table above provides examples of required information, NCUA will publish guidance on the report, providing specific information on the correct format, timing, and required information. The Board believes it is important to issue guidance on the specifics of the reporting to preserve maximum flexibility for the agency to adjust its information gathering to the changes in the ways in which CUSOs operate and conduct

business. As such, the regulatory text of this proposal contains the five broad categories above and a requirement that the reports be filed at least annually, rather than a list of required information and a set time frame for reporting. In addition to general reporting period for all CUSOs, the Board is also proposing to require newly formed CUSOs to file the report addressed in this section within 30 days after its formation. The Board believes this reporting requirement for new CUSOs will bridge any potential gaps between the formation of a CUSO and the annual reporting date and will allow NCUA to allocate resources in preparation for CUSO reviews that will happen in the following year. For purposes of this reporting requirement, the definition of “newly formed CUSO” includes a newly established business or an established business that becomes subject to this regulation by virtue of a credit union’s investment or loan to the business.

The Board believes that applying the current requirements in this section of the regulation to FISCUs as well as the addition of the new requirement regarding financial reporting of all CUSOs will allow NCUA to obtain accurate information on the CUSO industry and better evaluate the risks posed to credit unions and the NCUSIF. The ability to accurately inventory CUSOs and evaluate their financial condition is paramount to mitigating risk to the credit union industry as a whole.

#### Transition Period for Compliance.

The Board recognizes that FISCUs and FCUs with loans to or investments in CUSOs will be required under this proposal to make changes in the agreements they currently

have with their CUSOs. The Board proposes to establish a compliance date for these changes that is not earlier than six months following the date of publication of the final rule in the Federal Register.

*5. 712.9 When must an FCU comply with this part?*

This section currently states that FCUs must comply with the CUSO regulation by April 1, 2001 unless certain conditions are met. The Board recognizes that this section is outdated, and is proposing to delete and reserve this section for future use.

*6. 712.10 How can a state supervisory authority obtain an exemption for FISCUs from compliance with §712.3(d)?*

The Board is aware that some states may already have rules or requirements that govern financial reporting, audits, and accounting practices of FISCUs and their CUSOs. In line with the changes made in 2008, the Board is proposing to expand §712.10 to allow SSAs to obtain an exemption from compliance with certain provisions of §712.3(d). These proposed changes do not alter the way in which an SSA can obtain an exemption, but merely make changes that take into account the amendments made to §712.3(d) in this proposal. As stated in the current regulation, an SSA may obtain an exemption by demonstrating that compliance with an existing state rule adequately addresses NCUA's concerns. See current §712.10(b). The proposed changes would merely expand that section to allow an SSA to obtain an exemption from the

requirements of §§712.3(d)(1), (2), and (3), provided the state rules or laws address NCUA's concerns with the financial conditions of CUSOs present in the context of this section of the CUSO regulation. This section, however, would not allow an SSA to apply for an exemption from the financial reporting requirement in §712.3(d)(4). As noted above, it is imperative that NCUA maintain complete and accurate information on CUSOs and their relationships with FCUs and FISCUs. The Board is concerned that allowing an exemption from this requirement would result in inconsistent reporting based on the varying laws in the different states. Inconsistent information and reporting formats will impede NCUA's ability to accurately evaluate systemic risk posed by CUSOs.

*7. 712.11 What requirements apply to subsidiary CUSOs?*

The Board is proposing to add a new section to the CUSO regulation, applicable to both FCUs and FISCUs, prohibiting a credit union from investing in a CUSO unless all subsidiaries of the CUSO also follow all applicable laws and regulations. The treatment of CUSOs with subsidiaries was previously addressed in the preamble to a 1997 rule amending the CUSO regulation, but was never included in regulatory text. In the preamble to the 1997 proposed rule, the Board stated that the CUSO rule applies to all levels or tiers of a CUSO's structure and any entity in which a CUSO invests will also be treated as a CUSO and subject to the CUSO regulation. 62 FR 11781 (March 13, 1997). The Board believes it is appropriate at this time to include the requirement articulated in the 1997 preamble into the text of the regulation to ensure credit unions

and CUSOs are aware that the requirements of the CUSO rule and applicable state rules apply to all entities in which a CUSO invests. This requirement will only apply to entities in which a CUSO invests and will not apply to third parties with whom a CUSO contracts or otherwise does business. The Board believes without this change there is an inherent risk that a subsidiary CUSO could negatively impact the investing credit union and ultimately the NCUSIF. As noted above, the Board is also proposing to expand the definition of a CUSO in §741.222 to include entities in which a CUSO invests.

## **REGULATORY PROCEDURES**

### Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities. NCUA considers credit unions having less than ten million dollars in assets to be small for purposes of RFA. Interpretive Ruling and Policy Statement (IRPS) 87-2 as amended by IRPS 03-2. The proposed changes to the CUSO rule impose minimal compliance obligations by requiring credit unions to comply with certain regulatory requirements concerning agreements with CUSOs and investment limits. NCUA has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA has determined that an RFA analysis is not required.

## Paperwork Reduction Act

NCUA recognizes that this proposal requires FISCUs and FCUs to comply with certain requirements that constitute an information collection within the meaning of the Paperwork Reduction Act (PRA). 44 U.S.C. 3507(d). First, under this proposal, FISCUs with an investment in or loan to a CUSO will need to revise the current agreement they have with their CUSO to provide that the CUSO will account for all its transactions in accordance with GAAP, prepare quarterly financial statements and obtain an annual financial statement audit of its financial statements by a licensed certified public accountant, and submit a financial report directly to NCUA. According to NCUA records, of the 2,750 FISCUs that filed a form 5300 call report with NCUA as of December 31, 2010, 988 reported at least one interest in a CUSO; a total of 1,708 CUSO interests was reported. For purposes of this analysis, NCUA estimates that this requirement will affect all FISCUs reporting an interest in a CUSO. Using these estimates, information collection obligations imposed by this aspect of the rule, on an annual basis, are analyzed below:

Changing the written agreement relating to certain accounting and reporting requirements.

FISCUs with a reported interest in a CUSO, 12/31/2010:	988
Frequency of response:	one-time



Initial hour burden:

1

$$1 \text{ hour} \times 988 = 988$$

In addition to the requirement for FISCUs to revise their agreements with CUSOs, this proposal also requires FCUs with an investment in or loan to a CUSO to revise the current agreement they have with their CUSO to provide that the CUSO submit a financial report directly to NCUA. According to NCUA records, of the 4,589 FCUs that filed a form 5300 call report with NCUA as of December 31, 2010, 1,097 reported at least one interest in a CUSO; a total of 1,857 CUSO interests was reported. For purposes of this analysis, NCUA estimates that this requirement will affect all FCUs with a reported interest in a CUSO. Using these estimates, information collection obligations imposed by this aspect of the rule, on an annual basis, are analyzed below:

Changing the written agreement relating to financial reports to NCUA.

FCUs with a reported interest in a CUSO, 12/31/2010:

1,097

Frequency of response:

one-time

Initial hour burden:

1

$$1 \text{ hour} \times 1,097 = 1,097$$

The final aspect of this proposal that involves PRA consideration is the requirement pertaining to recapitalizing CUSOs that have become insolvent. The proposed rule would require certain FISCUs to seek and obtain prior approval from their state supervisory authority before making an investment to recapitalize an insolvent CUSO. According to NCUA's records, as of December 31, 2010, there were only 53 FISCUs that were less than adequately capitalized (i.e., net worth of under 6%). According to year-end 2010 call report data, 31 of these FISCUs currently have an interest in a CUSO. NCUA estimates it would take a FISCU approximately two hours to complete a request for the SSA's prior approval for an investment to recapitalize an insolvent CUSO.

Obtaining regulatory approval:

Total less than adequately capitalized FISCUs with an interest in a CUSO,	
12/31/2010:	31
Frequency of response:	one-time
Initial hour burden:	2

$2 \text{ hours} \times 31 = 62$

In accordance with the requirements of the PRA, NCUA intends to obtain a modification of its current OMB Control Number, 3133-0149, to support these proposed changes. Simultaneous with its publication of this proposed amendment to Part 712, NCUA is

submitting a copy of the proposed rule to the Office of Management and Budget (OMB) along with an application for a modification of the OMB Control Number.

The PRA and OMB regulations require that the public be provided an opportunity to comment on the paperwork requirements, including an agency's estimate of the burden of the paperwork requirements. The NCUA Board invites comment on: (1) whether the paperwork requirements are necessary; (2) the accuracy of NCUA's estimates on the burden of the paperwork requirements; (3) ways to enhance the quality, utility, and clarity of the paperwork requirements; and (4) ways to minimize the burden of the paperwork requirements.

Comments should be sent to: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, DC 20503. Please send NCUA a copy of any comments submitted to OMB.

### Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The major aspects of the rule make certain aspects applicable to state chartered, federally-insured credit unions. By law, these institutions are already subject to numerous provisions of NCUA's rules, based on the agency's role as the insurer of member share accounts and the significant interest NCUA has in the safety and soundness of their operations. In developing the

proposal, NCUA worked with representatives of the state credit union regulatory community. This proposed rule incorporates a mechanism by which states may request an exemption from coverage of part of the rule for institutions in that state, provided certain criteria are met. In any event, the proposed rule will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposal does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - - Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act.

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. NCUA does not believe, and will seek concurrence from the Office of Management and budget, that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

## **List of Subjects in 12 CFR Parts 712 and 741**

Administrative practices and procedure, credit, credit unions, insurance, investments, reporting, and record keeping requirements.

By the National Credit Union Administration Board on July 21, 2011.

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Mary F. Rupp  
Secretary of the Board

Accordingly, NCUA amends 12 CFR parts 712 and 741 as follows:

### **Part 712 - CREDIT UNION SERVICE ORGANIZATIONS (CUSOs)**

1. Amend the authority citation for part 712 to read as follows:

**Authority:** 12 U.S.C. 1756, 1757(5)(D), and (7)(I), 1766, 1781(b)(9), 1782, 1784, 1785, 1786 and 1789(11).

2. Revise §712.1 to read as follows:

**§712.1 What does this part cover?**

(a) This part establishes when a Federal Credit Union (FCU) can invest in and make loans to CUSOs. CUSOs are subject to review by NCUA. This part does not apply to corporate credit unions that have CUSOs subject to §704.11 of this chapter.

(b) Sections 712.2 (d)(3), 712.3(d), 712.4 and 712.11 of this part apply to federally insured state-chartered credit unions (FISCU), as provided in §741.222 of this chapter. All other sections of this part only apply to FCUs. FISCU must follow the law in the state in which they are chartered with respect to the sections in this part that only apply to FCUs.

(c) As used in §§ 712.2 (d)(3), 712.3(d), 712.4, 712.10, and 712.11 of this part, federally insured credit union (FICU) means an FCU or FISCU.

3. Revise §712.2(d)(3) to read as follows:

**§712.2 How much can an FCU invest in or loan to CUSOs, and what parties may participate?**

\* \* \* \* \*

(d) \* \* \*

(3) Special rule in the case of less than adequately capitalized FICUs. This rule applies in the case of a FICU that is currently less than adequately capitalized, as

determined under part 702, or where the making of an investment in a CUSO would render the FICU less than adequately capitalized under part 702. Before making an investment in a CUSO:

(i) An FCU must obtain prior written approval from the appropriate NCUA regional office if the making of the investment would result in an aggregate cash outlay, measured on a cumulative basis (regardless of how the investment is valued for accounting purposes) in an amount that is in excess of 1% of its paid in and unimpaired capital and surplus; or

(ii) A FISCU must obtain prior written approval from the appropriate state supervisory authority if the making of the investment would result in an aggregate cash outlay, measured on a cumulative basis (regardless of how the investment is valued for accounting purposes) in an amount that is in excess of the investment limit in the state in which it is chartered. A FISCU must also, and at the same time, submit a copy of its request for prior written approval to the appropriate NCUA Regional Office. If there is no state limit in the state in which a FISCU is chartered, the requirements in subsection (d)(3)(i) of this section will apply.

\* \* \* \* \*

4. Revise §712.3(d) to read as follows:

### 712.3 What are the characteristics of and what requirements apply to CUSOs?

\* \* \* \* \*

(d) CUSO accounting; audits and financial statements; NCUA access to information. A FICU must obtain written agreements from a CUSO before investing in or lending to the CUSO that the CUSO will:

(1) Account for all of its transactions in accordance with GAAP;

(2) Prepare quarterly financial statements and obtain an annual financial statement audit of its financial statements by a licensed certified public accountant in accordance with generally accepted auditing standards. A wholly owned CUSO is not required to obtain a separate annual financial statement audit if it is included in the annual consolidated financial statement audit of the FICU that is its parent;

(3) Provide NCUA, its representatives, and the state credit union regulatory authority having jurisdiction over any FICU with an outstanding loan to, investment in or contractual agreement for products or services with the CUSO with complete access to any books and records of the CUSO and the ability to review the CUSO's internal controls, as deemed necessary by NCUA or the state credit union regulatory authority in



carrying out their respective responsibilities under the Act and the relevant state credit union statute.

(4) Submit a financial report directly to NCUA and the appropriate state supervisory authority, if applicable. Pursuant to guidance duly adopted by the NCUA Board, a CUSO must submit a financial report at least annually, except in the case of a newly formed CUSO (including a pre-existing business which becomes subject to this regulation by virtue of a credit union investment or loan), which must file a financial report within 30 days of its formation, and the financial report must contain:

- (i) General information about the CUSO;
- (ii) A list of services;
- (iii) A customer list;
- (iv) Information on the CUSO's board and management; and
- (v) Balance sheet and income information.

\* \* \* \* \*

5. Revise §712.4 to read as follows:

**§ 712.4 What must a FICU and a CUSO do to maintain separate corporate identities?**

(a) Corporate separateness. A FICU and a CUSO must be operated in a manner that demonstrates to the public the separate corporate existence of the FICU and the CUSO. Good business practices dictate that each must operate so that:

(1) Its respective business transactions, accounts, and records are not intermingled;

(2) Each observes the formalities of its separate corporate procedures;

(3) Each is adequately financed as a separate unit in the light of normal obligations reasonably foreseeable in a business of its size and character;

(4) Each is held out to the public as a separate enterprise;

(5) The FICU does not dominate the CUSO to the extent that the CUSO is treated as a department of the FICU; and

(6) Unless the FICU has guaranteed a loan obtained by the CUSO, all borrowings by the CUSO indicate that the FICU is not liable.

(b) Legal opinion. Prior to a FICU investing in a CUSO, the FICU must obtain written legal advice as to whether the CUSO is established in a manner that will limit potential exposure of the FICU to no more than the loss of funds invested in, or lent to, the CUSO. In addition, if a CUSO in which an FICU has an investment plans to change its

structure under §712.3(a), a FICU must also obtain prior, written legal advice that the CUSO will remain established in a manner that will limit potential exposure of the CU to no more than the loss of funds invested in, or loaned to, the CUSO. The legal advice must address factors that have led courts to “pierce the corporate veil” such as inadequate capitalization, lack of separate corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records. The legal advice may be provided by independent legal counsel of the investing FICU or the CUSO.

6. Revise §712.9 to read as follows:

**712.9 [Reserved]**

7. Revise §712.10 to read as follows:

**712.10 How can a state supervisory authority obtain an exemption for FISCUs from compliance with §712.3(d)?**

(a) The NCUA Board may exempt FISCUs in a given state from compliance with §§712.3(d)(1), (2), and (3) if the NCUA Board determines the laws and procedures available to the supervisory authority in that state are sufficient to provide NCUA with the degree of access and information it believes is necessary to evaluate the safety and

soundness of FICUs having business relationships with CUSOs owned by FISCUs in that state.

(b) To obtain the exemption, the state supervisory authority must submit a copy of the legal authority pursuant to which it secures the information required in §§712.3(d)(1), (2), and (3) of this part to NCUA's regional office having responsibility for that state, along with all procedural and operational documentation supporting and describing the actual practices by which it implements and exercises the authority.

(c) The state supervisory authority must provide the regional director with an assurance that NCUA examiners will be provided with co-extensive authority and will be allowed direct access to CUSO books and records at such times as NCUA, in its sole discretion, may determine necessary or appropriate. For purposes of this section, access includes the right to make and retain copies of any CUSO record, as to which NCUA will accord the same level of control and confidentiality that it uses with respect to all other examination-related materials it obtains in the course of its duties.

(d) The state supervisory authority must also provide the regional director with an assurance that NCUA, upon request, will have access to copies of any financial statements or reports, which a CUSO has provided to the state supervisory authority.

(e) The regional director will review the applicable authority, procedures and assurances and forward the exemption request, along with the regional director's recommendation, to the NCUA Board for a final determination.

(f) For purposes of this section, whether an entity is a CUSO shall be determined in accordance with the definition set out in §741.222 of this chapter.

8. Add new section 712.11 to read as follows:

**712.11 What requirements apply to subsidiary CUSOs?**

(a) FCUs investing in a CUSO that invests in a CUSO. The requirements of this part apply to all tiers or levels of a CUSO's structure and FCUs may only invest in or loan to a CUSO, which has an investment in another CUSO, if the subsidiary CUSO satisfies all of the requirements of this part.

(b) FISCUs investing in a CUSO that invests in a CUSO. FISCUs may only invest in or loan to a CUSO, which has an investment in another CUSO, if the subsidiary CUSO complies with the following:

(1) All of the requirements of this part that apply to FISCUs, which are listed in §712.1;  
and

(2) All applicable state laws and rules regarding CUSOs.

(c) For purposes of this section, a subsidiary CUSO is any entity in which a CUSO invests.

### **Part 741 – Requirements for Insurance**

1. The authority citation for part 741 continues to read as follows:

**Authority:** 12 U.S.C. 1757, 1766, 1781-1790, and 1790d.

2. Revise §741.222 to read as follows:

#### **§741.222. Credit Union Service Organizations.**

(a) Any credit union that is insured pursuant to Title II of the Act must adhere to the requirements in §§712.2 (d)(3), 712.3(d), 712.4 and 712.11 of this chapter concerning permissible investment limits for less than adequately capitalized credit unions, agreements between credit unions and their credit union service organizations (CUSOs), the requirement to maintain separate corporate identities, and investments and loans to CUSOs investing in other CUSOs. For purposes of this section, a CUSO is any entity in which a credit union has an ownership interest or to which a credit union has extended a loan and that is engaged primarily in providing products or services to

credit unions or credit union members, or, in the case of checking and currency services, including check cashing services, sale of negotiable checks, money orders, and electronic transaction services, including international and domestic electronic fund transfers, to persons eligible for membership in any credit union having a loan, investment or contract with the entity. A CUSO also includes any entity in which a CUSO invests.

(b) This section shall have no preemptive effect with respect to the laws or rules of any state providing for access to CUSO books and records or CUSO examination by credit union regulatory authorities.