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

re: National Credit Union Administration; Credit Union Service Organization; 12 CFR Parts 712 and 741; 73 Federal Register 23982, May 1, 2008

Dear Ms. Rupp:

The American Bankers Association (ABA) opposes the National Credit Union Administration's (NCUA) proposed rule allowing credit unions to invest in Credit Union Service Associations (CUSO) that have expanded their activities and customer base well beyond the boundaries set by Congress.

The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

Allowing credit unions to invest in CUSOs with expanded activities and customer bases effectively increases the risks borne by credit unions. Should NCUA have oversight authority over CUSOs, it might be able to set standards that would protect the investing credit unions. However, unlike banking regulators, NCUA has no authority over CUSOs or other third-party vendors, so NCUA would be unable to ensure the safety and soundness of the credit unions that invest in these expanded CUSO powers.

Furthermore, this proposal far exceeds NCUA's stated purpose to "update, clarify, and simplify existing regulations and eliminate redundant and unnecessary provisions" and instead fundamentally changes the relationship between CUSOs, credit unions, and credit union members. This letter will lay out how the proposal modifies these relationships and how it would in the process endanger the safety and soundness of credit unions that invest in these CUSOs.

Background

NCUA's proposed rule would—

- Add two new categories of activities for CUSOs: origination of credit card loans and payroll processing services.
- Expand the customer base of CUSOs offering check and currency services and electronic transaction services.
- Establish a special rule for less than adequately capitalized federal credit unions (FCUs) to recapitalize a CUSO.
- Allow NCUA access to books and records of federally insured, state chartered credit unions that invest in a CUSO.
- Clarify that CUSOs are allowed to buy and sell loan participations that a CUSO is allowed to originate, with the exception of selling to a federal credit union the participation interest in a credit card loan.

CUSO History

The Federal Credit Union Act states that CUSOs were "established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve."[1] Moreover, CUSOs are to provide "services which are associated with the routine operations of credit unions."[2]

House Committee Report 95-23 of Public Law 95-22, which created CUSOs, makes it clear that 'credit union organizations' shall not include "corporations or other businesses which principally provide services to credit union members as opposed to corporations or businesses whose business relates to the daily in-house operation of credit unions."

The House Committee Report also stated that credit union service corporations were established to—

- provide data processing services;
- help develop small credit unions, through promotion, marketing and general management support;
- provide access to sophisticated accounting systems;
- provide non-profit debt counseling services;
- provide management training and education to credit union paid and volunteer personnel; and
- provide other services which are commonly associated with the routine operation of a credit union.

Since 1998, however, NCUA has amended 12 CFR Part 712.5 – "What activities and services are preapproved for CUSOs?" – five times. The frequency in NCUA's actions indicates the expanding nature of the CUSO activities. Many of these pre-approved activities go beyond the daily routine operation of credit unions and

[1] 12 U.S.C. 1757 (5) (B).
[2] 12 U.S.C. 1757 (7) (I).

parallel the credit union industry's efforts to move beyond the traditional service and mission of a credit union.

ABA's Position

ABA opposes the expansion of NCUA's CUSO authority, as it poses an increased safety and soundness concern to credit unions.

As the Government Accountability Office (GAO) noted in 2003, NCUA does not have the third-party oversight authority provided to other federal banking regulators, and the lack of such authority – coupled with the expansions in this proposed rule – could limit NCUA's effectiveness in ensuring the safety and soundness of credit unions. While CUSOs can help credit unions manage costs, provide expertise, and improve services to members, they also present risks. As credit unions make greater use of these third-party providers, credit unions subject themselves to operational and reputation risks. NCUA cannot examine third-party providers unless they have the permission of the CUSO.[3]

Although NCUA regulations require a credit union that either invests or makes a loan to a CUSO to obtain a written agreement permitting NCUA access to the CUSO's records, this has not been the practice. The GAO in its 2003 report cited instances where NCUA was either denied access to a third-party vendor or the third-party vendor withheld financial statements from NCUA examiners.

Therefore, without meaningful vendor examination authority, NCUA has no enforcement powers over a CUSO.

It is troubling that NCUA would seek to expand the range of activities and customer base of institutions it has no effective supervisory authority over. ABA believes that NCUA should not go forward with its proposed amendments to its CUSO regulations without statutory authority to regulate third-party vendors similar to the authority of banking regulators.

The following discussion is directed at specific aspects of the proposed rule, specifically, credit card loan origination, payroll processing services, and expansion of the customer base for CUSOs offering check and currency services and electronic transaction services.

Proposed Rule Represents an Unprecedented Expansion of CUSO Customer Base

NCUA is proposing to expand significantly the customer base for CUSOs offering checking and currency services and electronic transaction services. Currently, the customer base requirement restricts a CUSO to primarily serving credit unions, its

[3] NCUA regulations do require a federal credit union to obtain a written agreement before it **invests** in or makes a **loan** to a CUSO, the CUSO will provide NCUA or its representatives with complete access to any books and records of the CUSO and the ability to review CUSO internal controls, as deemed necessary by NCUA. There is not a similar requirement for credit unions that simply **contract** with a CUSO for service.

membership, or the membership of credit unions contracting with the CUSO. The proposed rule would expand the customer base of a CUSO offering checking and currency services and electronic transaction services to primarily serve "persons within the [federal credit union's] field of membership, or to persons eligible for membership in credit unions with which the CUSO has contracts."

NCUA justifies the expansion of the customer base of CUSOs, because Section 503 of the Financial Services Regulatory Relief Act of 2006[4] (FSRRA) authorized FCUs to "(a) to sell, to persons in the field of membership, negotiable checks (including travelers checks), money orders, and other similar money transfer instruments (including international and domestic electronic fund transfers); and (b) to cash checks and money orders and receive international and domestic electronic fund transfers for persons in the field of membership for a fee."

Since both an FCU and a CUSO may provide some or all these services authorized by Section 503 of FSRRA, NCUA concludes that the enactment of FSRRA warrants a parallel expansion in the customer base definition of a CUSO. Therefore, the proposed rule would amend the customer base to serve primarily persons eligible for membership in the credit union.

ABA objects to this proposed expansion in the CUSO customer base rule. While Section 503 of FSRRA expanded the customer base for FCUs offering check cashing and wire transfer services, it did not authorize a similar expansion in the customer base of a CUSO providing those services. In fact, the enabling legislation that created CUSOs made it quite clear that a CUSO shall not include "corporations or other businesses which principally provide services to credit union members."

Moreover, ABA believes the proposed customer base rule is ripe for abuse. NCUA has consistently refused to provide an objective definition of "primarily" serve. The NCUA Board in 1986 concluded "that defining the term as a percentage of business or percentage of customers served would be arbitrary."[5] In its place, NCUA has used an *a la carte* approach to defining primarily served, including such factors as "type of business(es) provided; number of affiliated members served; gross or net revenues derived from affiliated members; amount of affiliated members' assets under management; number of policies sold to affiliated members; number of services provided to affiliated members; and availability/access of services to affiliated members."[6] This *a la carte* approach ensures that NCUA can find some criteria under which a CUSO would comply with the primarily serve governor, permitting a wide open ability for a CUSO to expand.

ABA can only conclude that the proposed change in the "primarily" serve governor represents an unprecedented expansion in CUSO customer base with regard to the two aforementioned services. For example, LA Financial Credit Union, with almost 35,000 members, has a potential membership base of 9.9 million. Without a clear definition of primarily serve, a CUSO offering these services to LA Financial could

[4] P.Law 109-351.
[5] 51 Federal Register 10353 (March 26, 1986).
[6] 62 Federal Register 11779 (March 13, 1997).

hypothetically offer these services to an additional 9.9 million customers and still comply with this proposed regulation.

While not part of the proposed rule, ABA requests that NCUA provide an objective measure of what constitutes "primarily" serve.

Additionally, Section 503 of FSRRA enumerated a limited number of services that an FCU could offer to nonmembers within its field of membership. These services are limited to check cashing, money orders, travelers checks, electronic fund transfer services, and wire transfer services.

NCUA uses Section 503 of FSRRA as a justification for expanding a CUSO's customer base. This should therefore limit a CUSO to the services enumerated in Section 503 of FSRRA. However, NCUA's proposal goes well beyond those listed in Section 503 of FSRRA and would make all products and services identified under current 12 CFR 712.5(a) and 712.5(e) available to the new customer base definition for CUSOs.

ABA believes the proposed rule would impermissibly expand the following services to the new customer base definition:

- Coin and currency services,
- Savings bonds,
- Purchase and sale of U.S. Mint commemorative coins,
- ATM services,
- Credit card and debit card services,
- Data processing,
- Electronic income tax filing,
- Payment item processing
- Cyber financial services.

Therefore, ABA believes that NCUA should scale back the list of services to those enumerated under FSRRA.

It is important to note that this proposal could expose FCUs to significant reputational risk as it would allow CUSOs to engage in check cashing and wire transfer services without the required regulatory oversight by NCUA. Should a CUSO experience financial, legal, or reputational problems, this would directly tarnish the image of investing FCUs.

CUSO Involvement with Credit Cards Poses Risk to FCUs

The proposed rule would permit a CUSO to originate and hold credit card loans either as a principal on its own behalf or on behalf of credit unions. The NCUA explains that permitting a CUSO to engage in credit card lending is a logical extension of current service offerings in consumer mortgage, business and student loan originations. Additionally, NCUA believes that a CUSO can combine the scale, expertise, and back-office operational support to manage the risk associated with the credit card operation. Finally, the proposal is meant to give FCUs a credit union-owned alternative to taxpaying banks to sell their credit card portfolios.

This proposal would increase the risk to FCUs that invest or loan to or contract with a CUSO providing credit card originations. Credit card lending can be a risky form of consumer lending. Allowing an unlimited expansion of credit card lending by a CUSO on the behalf of a FCU without proper supervision and enforcement powers poses an enormous risk to a FCU.

Payroll Processing Services Distract Credit Unions from Mission of Serving People of Modest Means

NCUA's proposal would add payroll processing services to credit union members to the list of permissible activities allowed by a CUSO. This addition represents a fundamental departure from the agency's long held view that clerical and managerial services authorized for CUSOs may only be performed on the behalf of a FCU. Permitting a CUSO to offer this service directly to credit union members is inconsistent with the statutory requirement that the business relates to the daily operation of the credit union or services associated with the routine operation of credit unions.

Furthermore, it would seem that the real motivation for the proposed rule change is to expand credit union services to business customers. In justifying this proposed amendment, NCUA wrote that payroll servicing "is a very common ancillary service for business members and a key part of the business services package of services."[7] ABA believes that this proposed amendment to 12 CFR Section 712 would only further move FCUs away from their mission of serving consumers, especially those of modest means.

Conclusion

Credit unions were designed to provide targeted financial services to a well-defined group of individuals, especially those of modest means. The proposed expansion in product offerings and CUSO member participation requirements represents another instance of mission creep, moving FCUs beyond their intended mission.

ABA urges NCUA to withdraw the proposed rule. NCUA does not have regulatory oversight over third-party vendors limiting NCUA's effectiveness in ensuring the safety and soundness of credit unions. Before implementing the proposed amendments, NCUA should seek statutory authority, similar to that possessed by banking regulators, with regard to oversight authority of third party vendors.

Sincerely,

Keith Leggett

[7] 73 Federal Register 23982 (May 1, 2008).