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Via Electronic Submission

March 25, 2021

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

Dear Secretary Conyers-Ausbrooks:

The Independent Community Bankers of America ("ICBA")[1] is writing in response to the National Credit Union Association's ("NCUA") proposal to amend its credit union service organization ("CUSO") rule, which would greatly expand permissible activities for CUSOs and grant the NCUA Board ("Board") flexibility to approve additional activities without notice and comment rulemaking. Given that this proposal would severely deregulate CUSOs without implementing appropriate safeguards or supervisory oversight, ICBA believes that this proposal is misguided and should be withdrawn.

Background

Under the Federal Credit Union Act ("FCU Act" or "Act"), a Federal Credit Union ("FCU") has the authority to lend up to one percent of its paid-in and unimpaired capital and surplus, and to invest an equivalent amount, in CUSOs.[2] NCUA regulations define a CUSO as an organization: (1) in which a federally insured credit union ("FICU") has an ownership interest or to which a FICU has extended a loan; (2) is engaged primarily in providing products and services to credit unions, their membership, or the membership of credit unions contracting

[1]*The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.*

With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5 trillion in assets, over $4.4 trillion in deposits, and more than $3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

[2] 12 U.S.C. 1757.

with the CUSO; and (3) whose business relates to the routine daily operations of the credit unions it serves.[3]

Currently, the list of permissible CUSO activities includes checking and currency services, consumer mortgage loan origination, business loan origination, and student loan origination.[4] The Board does not have flexibility to consider additional activities and services without engaging in the Federal rulemaking process.

The Board is proposing to amend the NCUA's CUSO regulation to permit CUSOs to originate any type of loan an FCU may originate and grant the Board additional flexibility to approve permissible activities and services without complying with the Administrative Procedure Act rulemaking process. Under the proposed rule, CUSOs would be permitted to originate, purchase, sell, and hold any type of loan permissible for FCUs to originate, purchase, sell, and hold, including origination of consumer credit and automobile-secured loans. Under the proposed rule, the list of permissible activities in NCUA regulations would include a catchall category for other activities as approved in writing by the NCUA and published on the NCUA's website.

ICBA Comments

CUSOs Operate in the Shadows of the Credit Union Industry

Currently, NCUA does not have statutory authority to examine and supervise CUSOs. Several federal agencies, including the Government Accountability Office and the Financial Stability Oversight Council, have recommended and requested that NCUA be given supervisory oversight of CUSOs.[5] Additionally, the Chairs of every NCUA Board over the past decade, as well as NCUA's Inspector General, have recognized the growing risks that emanate from CUSOs, similarly calling for the ability to examine and supervise CUSOs.[6]

This lack of examination and supervision presents a significant regulatory blind spot on the credit union sector; and if NCUA were to finalize this proposed rule, it would exacerbate the existing problems that arise from the inability to supervise CUSOs. Yet, despite the widely acknowledged risk that stems from the opaqueness of CUSOs, NCUA is seeking to expand

[3] 12 CFR 712.1(d), 712.3(b), and 712.5.
[4] 12 CFR 712.5.
[5] *See* NCUA Office of Inspector General Report, "Audit of the NCUA's Examination and Oversight Authority Over Credit Union Service Organizations and Vendors" Report #OIG-20-07, Sept. 1, 2020, (hereinafter "NCUA IG Report") recommending that the FCU Act be amended to provide NCUA with supervisory authority over CUSOs and third-party vendors, and finding, at 13, "The Financial Stability Oversight Council (FSOC)… supports providing the NCUA with statutory examination and enforcement authority, as does the Government Accountability Office (GAO) when it made a recommendation consistent with the FSOC's position in a July 2015 report on cybersecurity."
[6] NCUA IG Report, stating, "Our audit also determined that since 2004, the last four NCUA Board Chairmen have led an effort through Congressional committee testimony to amend the Federal Credit Union Act to provide the NCUA with the authority over CUSOs to hold them accountable for unsafe and unsound practices."

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CUSO powers and make this blind spot even larger. NCUA is proposing to provide CUSOs with all the powers of credit unions, but with none of the commensurate prudential supervision or consumer safeguards to mitigate the risk. In short, NCUA's proposal would grow the activities of an unsupervised sector of the industry, casting a greater shadow on a sector that increases the risk of harm to consumers, the risk of loss to the National Credit Union Share Insurance Fund ("NCUSIF"), and the risk of further eroding the mission and characteristics of credit unions.

NCUA must acknowledge how CUSOs are:

1. separate entities from credit unions;
2. not supervised by NCUA;
3. not mutually-owned;
4. not member-owned;
5. not required to serve only credit union members;
6. privately-owned;
7. often, for-profit;
8. not capped by usury rates in the Federal Credit Union Act; and,
9. not required to limit concentration risk, manage loan-to-value ratios, maintain minimum capital levels, or follow other prudential safeguards.

CUSOs are exempt from consumer protection laws in the Federal Credit Union Act

Although FCUs are required to comply with consumer protection laws enumerated in the FCU Act, CUSOs are not similarly bound or required to comply with the same consumer protection laws. For example, federal credit unions are not permitted to originate loans at a rate that exceeds 15 percent per annum.[7] Yet, if a federal credit union wanted to avoid that usury ceiling, the FCU could easily direct the member to a CUSO in which it has an ownership interest for a loan, which has no such usury cap. Shedding light on this practice, former NCUA Board Chair Debbie Matz explained, "Many of the processes that go through CUSOs–originating speculative business loans, steering subprime indirect auto loans and selling risky loans to other credit unions–expose credit unions to undue risk."[8]

Additionally, while FCUs are member-owned and statutorily mandated to serve people of modest means,[9] there are no such requirements in the FCU Act for CUSOs. In contrast, many CUSOs are for-profit entities, not owned by credit union members, and not required to have a Board of Directors comprised of members.[10]

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[7] 12 U.S.C. §1757(5)(A)(vi).

[8] Marx, Claude R., "CUSO Regs Readied by the NCUA," Credit Union Times, Jul. 17, 2011.

[9] The preamble to the Credit Union Membership Access Act referred to credit unions meeting "the credit and savings needs of consumers, especially persons of modest means," Pub. L. No. 105-219, § 2(4), 112 Stat. 913. (August 7, 1998).

[10] *See* NCUA IG Report at 5, A CUSO has its own board of directors and management that operate separately from the credit union's board and management; *also see* NCUA IG Report at 13, CUSOs may be owned by non-credit unions and are required to be separate and distinct from credit unions.

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Yet even if NCUA were given the power to supervise CUSOs for consumer protection, it is not certain whether the Agency would have the capacity to do so. For example, a recent NCUA Inspector General report found that NCUA does not investigate whether laws were broken when overseeing complaints: "Based on our review of complaints, we determined that the agency's consumer complaint process focuses mostly on assisting consumers with resolving consumer complaints with their credit union as opposed to determining whether the credit union has violated a law or regulation… Because the credit union resolves the issue with the consumer without a violation determination, the credit union could continue violating the consumer protection law after it resolves the complaint."[11] Additionally, NCUA still has not sufficiently budgeted to have a consumer protection staff that conducts fair lending exams on a parity basis with other federal banking agencies. For example, the National Community Reinvestment Coalition recently noted that as the number of consumer complaints received by the NCUA rose from 3,480 in 2013 to 53,337 in 2018, the number of fair lending exams and supervisory contacts decreased from 70 to 66 over the same time period.[12]

If NCUA intends to continue to expand the powers of CUSOs without the ability to implement commensurate oversight authority, then ICBA recommends that NCUA exercise Sections 1, 3(A) and 5(A) and (B) in its recently executed Memorandum of Understanding ("MOU") with the Consumer Financial Protection Bureau ("CFPB"), which provides for document sharing, coordination of covered examinations, and coordination on supervisory and enforcement actions.[13] Unlike NCUA, the CFPB <u>does</u> have requisite authority to examine CUSOs to determine whether consumer protection laws are being followed. The CFPB can then share its examination findings with NCUA to eliminate the supervisory shadow under which CUSOs currently operate.

CUSOs are not subject to prudential safety standards

Growth of industry is understandable, but it is the regulator's duty to ensure that the growth is measured and built upon a foundation that is safe and sound. Prudent regulation would offset the risk inherent in greater CUSO powers. Yet because CUSOs are not subject to prudential regulations, NCUA is not able to create a mechanism that manages the risk that CUSOs present.

The FCU Act and NCUA regulations impose several limits and constraints on FCUs to ensure they do not pose an undue risk to the NCUSIF. For example, since business lending

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[11] NCUA Office of Inspector General, Audit of the NCUA's Consumer Complaint Program, Report #OIG-21-01, Feb. 9, 2021.
[12] Van Tol, Jesse, National Community Reinvestment Coalition, Comment Letter in Response to NCUA 2020-2021 Budget, Dec. 2, 2019.
[13] Memorandum of Understanding between the Consumer Financial Protection Bureau and the National Credit Union Administration Regarding Enhanced Cooperation and Coordination, *available at* https://files.consumerfinance.gov/f/documents/cfpb_ncua-memorandum-of-understanding_2021-01.pdf.

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is complex and has led to certain losses, the FCU Act limits credit union lending to 1.75 times the actual net worth of the credit union.[14] NCUA regulations also place loan-to-value ratio requirements on commercial loans[15] and typically require personal guarantees from the borrower.[16] Yet unlike FCUs, CUSOs are not required to abide by any of these limits.[17]

Similarly, FCUs have capital requirements to ensure they are well capitalized and operating in sound financial health. If a FCU becomes less than well or adequately capitalized, NCUA subjects the credit union to enhanced supervision and limits the credit union's activity until its net worth rises to a more appropriate level.[18] Here again, CUSOs do not have those limits.

As NCUA explained in 1982, when it first started deregulating CUSOs, "substantial deregulation...can lead to the possibility of abuse and unsafe or unsound practice. Therefore, it is imperative that the NCUA Board retain the option to examine, if necessary."[19]

Increasing the loans that CUSOs originate increases the amount of off-balance sheet risk for the NCUSIF. Though credit unions are limited to one percent of investments and one percent of loans to CUSOs, there must be an acknowledgement and a mechanism to mitigate the interconnectivity effect of a large CUSO's failure. For example, what would happen if a CUSO that is large and systemically integrated into the credit union industry failed or ran into trouble? What would happen to the NCUSIF? If several or even several dozens of credit unions have investments tied-up in CUSOs, what would the effect on the industry be?

Unfortunately, NCUA does not have to speculate. These same questions and issues were raised by former Board Chair Debbie Matz when past failures in oversight of CUSOs inflicted real harm to the NCUSIF. Former Chair Matz detailed several examples of how CUSOs pose a threat to the safety and soundness of the NCUSIF, explaining how CUSO failures led to failed credit unions, and in turn, led to losses in the NCUSIF. As she stated, "[t]he sudden failures of several large, interconnected financial companies during the crisis triggered a cascade of more failures and near-failures of financial companies previously thought invulnerable…Even the consumer-oriented, member-owned credit union system suffered sizable losses."[20]

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[14] 12 U.S.C. 1757a(a).
[15] 12 C.F.R. 723.4(f)(5).
[16] 12 C.F.R. 723.5.
[17] *See* Congressional Testimony of J. Mark McWatters to Senate Committee on Banking, Housing and Urban Development, Hearing on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act, Oct. 2, 2018, stating, "Currently, the NCUA may only examine CUSOs and third-party vendors with their permission and cannot enforce any necessary corrective actions…without
enforcement authority, they are free to reject the NCUA's recommendations to implement the appropriate corrective actions that would mitigate identified risks."
[18] 12 CFR § 702.202.
[19] 47 FR 30462 (July 14, 1982).
[20] Congressional Testimony of Debbie Matz to the House Committee on Financial Services, Hearing on Oversight of the Financial Stability Oversight Council, Dec. 8, 2015.

Former NCUA Board Chair Mark McWatters similarly noted the risk that CUSOs pose to the safety and soundness of the NCUSIF, and also calculated the total damage, stating, "Since 2008, CUSOs have caused more than $500 million in losses to federally insured credit unions, and they have contributed to the failure of 11 credit unions…more than half of the NCUA's institutions hold less than $33 million in assets and average approximately three to four full-time employees per institution. These institutions are heavily dependent on third-party outsourced services and do not possess the resources to independently perform full due diligence on all of their critical services providers."[21]

NCUA should be granted greater authority over CUSOs before any action is pursued that would increase their risk and interconnectedness in the credit union industry. However, if NCUA insists on moving forward with this proposal, ICBA intends to urge the Financial Stability Oversight Committee to use its authority to study CUSOs to determine whether CUSOs present a systemic risk to the NCUSIF, and whether prudential oversight of CUSOs is warranted.

Continued erosion of the credit union mission

This proposal is the latest in a series of actions by NCUA that unfortunately prioritizes credit union growth over credit union members. Given that CUSOs are not cooperatively owned by credit union members, nor are CUSOs even required to serve credit union members or comprise CUSO boards of credit union members, NCUA is misplacing its efforts by accommodating credit unions and their senior executives rather than bettering the members of those credit unions.

Despite the claim in the proposed rule's preamble that CUSOs help enable smaller credit unions, NCUA's repeated concerns over the competitive threats of CUSOs indicate otherwise. NCUA has always struggled with the competitive threat that CUSOs pose to smaller credit unions. Past NCUA Boards have been concerned that CUSOs only benefit large credit unions to the detriment of smaller credit unions. For example, in 1982, NCUA proposed greatly deregulating CUSOs, and received comments that were opposed to the proposal on the grounds that it would be detrimental to smaller credit unions that "could not afford to take advantage of expanded opportunities."[22] Then again, in 1997, NCUA noted concern regarding the competitive effect of CUSOs against smaller credit unions, stating, "NCUA has been concerned over some reports that smaller credit unions have been unable to meet minimum investment or other eligibility requirements in order to partake of CUSO services."[23]

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[21] Congressional Testimony of J. Mark McWatters to Senate Committee on Banking, Housing and Urban Development, Hearing on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act, Oct. 2, 2018.
[22] 47 FR 30462 (July 14, 1982).
[23] 62 FR 11779

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A past NCUA administration said it best: "NCUA is apprehensive in granting CUSOs authority to provide consumer loans to the general public, as it may be perceived as a dilution of the common bond by Congress and the public. NCUA is also concerned that if member loans were being made by CUSOs, NCUA would have a duty to examine such loans which would lead to stricter NCUA examination authority over CUSOs."[24]

NCUA's continued focus on large credit union growth, and de-prioritization of small credit unions and credit union members, continues to show negative results. Recent research and call report figures similarly show that NCUA's focus on larger credit unions is a detriment to the smaller credit unions and the members they serve.[25] Recent NCUA policy is hurting its industry's brand identity and mission.

Conclusion

CUSOs are not supervised like credit unions. They do not adhere to consumer protections like credit unions. They do not abide by prudential constraints like credit unions. They are not non-profit like credit unions. They are not member-owned; they can be owned by non-credit unions, focused on driving profit. Simply put, CUSOs act like "shadow credit unions" that are not accountable to NCUA nor credit union members. NCUA should tamp down their powers, not further enable their growth. Should you like to discuss these comments further, please do not hesitate to contact me at Michael.Emancipator@icba.org or 202-821-4469.

Sincerely,

/s/

Michael Emancipator
Vice President and Regulatory Counsel

[24] 62 FR 11779

[25] *See* Diekmann, Frank J., "The Other Financial Well-Being (That Really Matters), CUToday.info, Mar. 3, 2021, noting that credit unions in every asset category below $500 million lost both members and loans in 2020; also stating, "the leaders of many of those shops (credit unions with assets of less than $500 million) have expressed to me in the past their own bewildered and disappointed belief the powers-that-be in the "system" don't really care much if they are rubbed out. And by rubbed out, we all know that means merged out."