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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 704, 712 and 740

Organization and Operations of Federal Credit Unions; Corporate Credit Unions; Credit Union Service Organizations; Advertising

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The final regulation updates, clarifies and streamlines existing rules concerning credit union service organizations (CUSOs), a common means of outside provision of services to federal credit unions (FCUs) and to credit union members. The final rule clarifies NCUA's authority to review CUSO books, records, and operations, adds corporate separateness requirements and additional permissible services, changes the legal opinion requirements, maintains safety and soundness criteria, and ensures the continuity and growth of services to FCUs and their members conducted through CUSOs. Related conforming changes are also made to credit union service contract, fixed asset, and corporate credit union rules.

DATES: This rule is effective April 1, 1998, except for § 712.3(d) which is effective December 31, 1998.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

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SUPPLEMENTARY INFORMATION:

I. Background

A. General

In 1977, Section 107 of the Federal Credit Union Act (12 U.S.C. 1757(5)(D) and (7)(I)) was amended to authorize FCUs to invest in, and make loans to, CUSOs subject to certain funding limits and other regulatory restrictions. The first CUSO rule was promulgated in 1979; the last major revision of this rule was in 1986. In general, the results of the 1986 revision have been positive. Nonetheless, over ten years of experience with the regulation indicated that there was a need for additional simplification, clarification, and improvement.

B. Proposed Rule

On March 7, 1997, the NCUA Board issued a proposed rule to revise its CUSO rules, §§ 701.26(b), 701.27, and 740.3(c). 62 FR 11779 (March 13, 1997). The proposal recodified the CUSO rules in part 701 into a new part 712 using a plain English format, streamlined existing requirements, added eight new CUSO services, and suggested other technical changes. In addition, the proposal suggested a change to required service center advertising to reduce regulatory burden. The purpose of the proposed rulemaking was to request public comment on reducing regulatory burden and increasing the flexibility and usefulness of CUSOs, while ensuring the safety and soundness of FCUs and the National Credit Union Share Insurance Fund (NCUSIF). The comment period was extended from May 12, 1997, to June 12, 1997, in order to give commenters more time to consider their comments. 62 FR 19702 (April 23, 1997).

C. Comments

The Board received 90 comments: 24 from FCUs; 10 from state chartered credit unions; 2 from corporate credit unions; 31 from CUSOs; 6 from national trade associations; 12 from state credit union leagues; 1 from an insurance company; and 4 from law firms. The majority of commenters supported the general approach of the proposed rule, but suggested specific changes. Where a majority of commenters disagreed with the proposed rule, NCUA has made efforts to address the commenters' concerns. NCUA thoroughly evaluated the comments and incorporated many of the suggested changes into this final rule. In addition, NCUA staff researched NCUA's experiences with CUSOs and the relevant regulations, guidance, legal interpretations and reporting requirements of NCUA and the other federal financial institution regulators in composing this final rule.

D. Final Rule

The final rule establishes limits on FCU investments in, and loans to, CUSOs. Inasmuch as is possible within the boundaries of safety and soundness, NCUA will permit FCUs and CUSOs to operate flexibly within the new limits of this rule. At the same time, the final rule attempts to minimize the regulatory burden on those FCUs with CUSO involvement. The purposes of this final rule are in accord with the Regulatory Reinvention Initiative of the Vice President's National Performance Review and the NCUA Board's Regulatory Relief Project.

An underlying premise of the regulation is that an FCU will use good business practices and maintain proper safeguards in transactions involving CUSOs. Many FCUs will, as part of their standard business practice, establish policies and procedures which properly go beyond the minimum requirements of this rule. NCUA encourages good business practices, even if not required by this rule.

E. Small Credit Unions

NCUA requested comment on how small credit unions, especially community development and low-income designated credit unions and their members, could best be served by CUSOs. CUSOs can enable smaller credit unions to expand the types of products and services offered to their memberships, offer economies of scale, enhance members' lives, and increase hours of service and locations through automated teller machines (ATMs), service centers, and other CUSO services. In addition, CUSOs can result in more favorable penetration rates of potential members through the broader availability of financial services. CUSOs can also facilitate a transfer of knowledge and expertise from larger, full-service credit unions to smaller, more limited service credit unions, which can have long-term positive implications upon safety and soundness.

Most comments regarding small credit unions shared NCUA's concerns and support CUSO incentives for small credit unions. Seven out of the eight relevant comments agreed that small credit unions should have reduced

minimum CUSO investment requirements. Also, nine out of the eleven relevant comments agreed that small credit unions should have reduced or waived transaction costs. Commenters not in favor were opposed to additional government regulation. One commenter suggested that CUSOs consider creating special ownership programs for small credit unions that would enable them to participate and use the CUSO's services. Many of the small credit union comments favored an industry solution instead of additional government regulation and the attendant compliance burdens. Allowing the CUSO industry to be creative and address the small credit union issues on a case-by-case basis depending upon each CUSO, the services offered, and the credit unions involved could lead to unfettered flexibility and economically sound policies, according to these comments. NCUA is in agreement with these comments. With NCUA's review authority over CUSOs, NCUA will be in a good position to monitor these independent efforts and to address any abuses it finds. Therefore, the Board has decided not to impose any CUSO rule requirements regarding small credit union CUSO activities at this time.

Other commenters requested special regulatory relief for small credit unions. One commenter suggested allowing any credit union with under $250,000 in assets to be considered an ''affiliated credit union.'' Another commenter suggested that credit unions with less than $50 million in assets should be subject to an easier, less restrictive set of NCUA regulations. A third commenter advised NCUA to be cautious in treating different classes of credit unions differently due to the possibility of splitting the credit union movement into two groups, with potentially negative tax and field of membership legislative consequences. Some of these solutions are outside of the scope of this rulemaking. Therefore, the Board will take these suggestions under advisement for possible future regulatory action.

F. Plain English Format

The rule was proposed as part 712 of NCUA's regulations and presented in a plain English question and answer format. The goal of plain language drafting is to decrease confusion, inadvertent errors, the need to seek clarification in correspondence and phone calls, and the amount of staff time credit unions must devote to understanding the regulations. As in the proposal, the final rule has no separate paragraph for definitions; instead, definitions appear next to their primary use in the regulatory text. Eighteen of the twenty relevant comments received supported the use of the plain English format. One commenter held that the CUSO section should remain in part 701, Organization and Operations of FCUs, and found the plain language format unnecessary. Another commenter found that the section headings in question format did not give a complete understanding of the regulatory requirements contained in the answer portion of the section. The Board agrees with the majority of the comments that the plain language format increases regulatory comprehension, user compliance, and administrative efficiency. Therefore, with minor modifications, the format used in the proposed rule is also used in the final rule.

One modification made by the Board concerns the substitution of the term ''you'' for the term ''FCU.'' Several commenters agreed with NCUA's statement in the proposed rule preamble that the use of the term ''you'' was confusing, as the same term variously applied to affiliated credit unions, FCUs with investments in CUSOs, and all FCUs with loans or investments in CUSOs. In order to avoid potential confusion, the Board has deleted the term ''you'' from the final regulation. Instead, the final rule uses the term ''FCU.'' When rule language is applicable to a limited class of FCUs the specific limitation is noted in adjacent rule language. For example, the legal opinion requirements of § 712.4(b) apply to ''an FCU investing in a CUSO.''

In addition, a few comments requested that the Board produce a commentary on the new CUSO rule. The Supplementary Information to the revised rule provides substantial guidance, and additional commentary is not necessary. NCUA may consider issuing additional commentary in the future if the need appears.

G. Section-by-Section Analysis

Section 701.26(b), Credit Union Service Contracts

NCUA solicited comments on whether § 701.26(b) is outdated, imposes regulatory burden, and is unnecessary. Thirty-nine out of 40 commenters agreed with the removal of the section, which currently mandates that a vendor service contract requiring the advance payment of more than 3 months converts the advance payment into an investment in a CUSO. Comments confirmed that the business practices of many vendors, especially data processors and ATM providers, either require such payments or give a discount to the purchasing credit union for paying in advance. In addition, some comments argued that removal would give FCUs the opportunity to conduct their own business analysis of the costs and benefits of such pricing arrangements without being subject to the service rule limit. The rule, applicable to FCUs, also did not sufficiently establish authority over third party vendors and was rarely enforced. For these reasons, the Board removes § 701.26(b).

Sections 701.36 and 704.11

Cross-referencing changes are made to the fixed asset rule, § 701.36(a)(4)(iv) and to § 704.11(e) by revising ''§ 701.27'' to read ''part 712.'' No change in meaning is intended by these amendments.

Part 712

In order to assist readers, NCUA proposed the substitution of § 701.27 with part 712. The rule applies to FCUs, but is of much interest to other parties such as CUSOs and other CUSO investors. It is hoped that, by giving CUSOs their own section of NCUA's Rules and Regulations, the rule will be better known, resulting in increased compliance and a reduction of NCUA staff time spent interpreting the regulation. Raising the rule to a part also results in more convenient citations with fewer subsections. Comments received on the substitution were generally favorable and the Board adopts part 712 for CUSOs.

Section 712.1, What Does This Part Cover?

Proposed § 712.1 condensed § 701.27(a), Scope, by eliminating statutory citations and a summary of rule requirements contained elsewhere in the rule. Several changes were made in response to various comments.

NCUA proposed an expansion of the term ''affiliated credit union'' in order to enable credit unions being served by a CUSO through NCUA's group purchasing rule, 12 CFR part 721, to count for purposes of the customer base requirement. The intent of the proposal was not to penalize CUSOs for serving members of credit unions that may be permissibly served under the group purchasing rule. Forty-two out of 52 commenters addressing the issue supported the proposal. Favorable comments stressed that this was a matter of equity and fairness well within NCUA's authority to interpret the FCU Act. Opposing comments argued that the proposal was either too liberal or too conservative in scope.

One opposing comment held that the addition diluted the field of membership common bond rules applicable to FCUs and was beyond NCUA's statutory authority to grant. NCUA strongly disagrees with both of these arguments. First, common bond laws apply only to FCUs, not to CUSOs. 12 U.S.C. 1759 and NCUA Interpretive Ruling and Policy Statement No. 94–1, 59 FR 29066 (June 3, 1994), as modified. Second, the Board has authority to prescribe rules for the administration of the FCU Act. 12 U.S.C. 1766(a). The loan authority for CUSOs in the FCU Act specifically reads: ''[a] credit union organization means any organization *as determined by the Board*, which is 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.'' 12 U.S.C. 1757(5)(D) (emphasis added). Similarly, the investment authority for CUSOs in the FCU Act defines CUSOs as: ''any other organization, providing services which are associated with the routine operations of credit unions . . . *with the approval of the Board*.'' 12 U.S.C. 1757(7)(I) (emphasis added). It is clear that the Board has ample authority to define customer base requirements for CUSOs.

Nine opposing comments stated that the proposal was too limiting and should be even broader in order to apply to all credit unions and their members. Some of these comments suggested that, instead of changing the definition of ''affiliated credit unions,'' it would be simpler to change the customer base requirements to capture these credit unions. After due consideration, and in light of the comments on potential reader confusion detailed in § F, Plain English Format, of this Supplementary Information, the Board has decided to adopt this approach. The term ''affiliated credit union'' has been deleted from the rule. Instead, the term ''FCU'' is used and any conditions on the types of FCUs affected (e.g., investing FCUs) is placed in adjacent regulatory language. This approach should be clearer, avoid confusion, and result in administrative efficiency. Furthermore, this change moots several comments proposing alternate language for the ''affiliated credit union'' definition.

Eight comments asked that NCUA clarify in § 712.1 the extent to which state-chartered credit unions and their subsidiaries would be affected by this revision. Part 712 applies only to FCUs and to CUSOs with FCU investment or loans. Part 712 does not apply to state-chartered credit union subsidiaries that have no FCU investments or loans. The Board makes this clarification in the final rule by adding a statement to this effect in § 712.1. However, if an FCU invests in, or loans to, a state-chartered credit union subsidiary it will trigger compliance with Part 712. These hybrid CUSOs will need to comply with both state laws and applicable federal laws, especially Part 712.

Two commenters criticized NCUA's special reserve requirements for state-chartered credit union CUSO services that are not required for an FCU's CUSO. As NCUA has previously stated many times, ''[f]or safety and soundness reasons, this requirement is and for many years has been imposed on federally insured, state-chartered credit unions (FISCUs) by the Agreement for Insurance of Accounts signed and agreed to by all insured state chartered credit unions as a condition of insurance.'' 60 FR 58502 (November 28, 1995, adopting new 12 CFR Part 741). Subsection 741.3(a)(3), Special reserve for nonconforming investments, will continue to apply to investments by FISCUs in subsidiaries of state-chartered credit unions providing services that cannot be provided by CUSOs having FCU investments or loans. Any revision regarding special reserves is outside the scope of this rulemaking.

In the proposed rule preamble, NCUA noted that its new corporate credit union rule contains a new section on corporate CUSOs that would apply instead of the provisions of the natural person credit union CUSO rule, as is the case currently. 12 CFR 704.11. Three commenters asked NCUA to add this cross-reference to § 712.1 and to provide clarifying guidance for CUSOs that have both natural person credit union and corporate credit union involvement. Since the comments did not identify any specific problems, it is difficult to provide guidance on any potential conflicts that might arise. NCUA believes that it is unlikely any conflicts will arise, and, if they do, the conflicts can be handled using standard supervisory tools on a case-by-case basis. Therefore, NCUA will not speculate on any potential conflicts at this time. However, the Board has decided to add a specific cross-reference to aid CUSOs with dual corporate and natural person involvement.

Additionally, the proposed sentence reading: ''[t]his part does not regulate CUSOs directly, but rather establishes conditions of your [FCU] investments in, and loans to, CUSOs'' has been deleted. Its replacement reads: ''CUSOs are subject to review by NCUA.'' The reasons for this change are discussed in § 712.3(d), under the subheading ''NCUA Access to Information,'' in this Supplementary Information.

Section 712.2, How Much Can an FCU Invest in, or Loan to, CUSOs, and What Parties May Be Involved?

NCUA proposed elimination of § 701.27(b)(1–2), which is a reprinting of the FCU Act provisions relating to CUSOs to avoid repetition of regulatory requirements. A few commenters requested that the statute continue to be reprinted with the new rule. This seems contrary to plain language precepts and an unnecessary practice when the statutory requirements are all contained in other rule provisions. Therefore, the Board removes the reprinting of FCU Act language from the new rule.

Limits on Funding

The funding limitations contained in proposed § 712.2 (a) and (b) are statutory in nature and required by § 107(5)(D) and (7)(I) of the FCU Act. 12 U.S.C. 1757(5)(D) and (7)(I). An FCU cannot invest more than one percent of its paid-in and unimpaired capital and surplus in CUSOs. Nor can an FCU loan more than one percent of its paid-in and unimpaired capital and surplus to CUSOs. Paid-in and unimpaired capital and surplus means shares and undivided earnings.

Four commenters asked NCUA to change the FCU investment and loan limitations. It is beyond the authority of the NCUA Board to change the FCU Act; only Congress has that authority. Other commenters asked for NCUA to clarify that FCUs can use their CUSO investment and lending authorities at the same time. To avoid any potential confusion on this issue, a clarification that the 1% investment and 1% loan authority are separate and independent has been added to § 712.2(b), Loans.

One comment asked that NCUA clarify how FCUs could invest in corporations, limited partnerships, and limited liability companies. To address this important issue, NCUA has added clarification to the end of § 712.2(a), Investments, stating that an FCU can only invest in a CUSO as a stockholder of a corporation, as a member of a limited liability company, or as a limited partner of a limited partnership. The terms ''corporation,'' ''limited liability company,'' and ''limited partnership'' have the meanings attributed to them in § 712.3(a) of this part. For liability reasons, FCUs are prohibited from investing as a general partner in a general partnership, either directly or indirectly.

The NCUA Board would like to clarify the scope of covered CUSO investments and loans. In the past, NCUA has

deemed all of the following to be either loan or investment equivalents in the context of the CUSO rule: standby letters of credit issued by FCUs to cover a CUSO; sale and leaseback transactions; installment sales and other similar equipment financings; payments of CUSO expenses by FCUs, such as subsidies; guarantees of CUSO debt or purchase of CUSO debentures; FCU pledges and guarantees of loans from other entities to the CUSO; and FCU spin-offs of assets to CUSOs. All of these loan and investment cash equivalents are used in determining the actual aggregate cash outlay figure.

For compliance purposes, FCUs should generally use the aggregate cash outlay figure to compute the statutory CUSO investment and loan limits. This number would equal the total amount of FCU funds either invested in, lent to, or available to be lent under a line of credit with the FCU to the CUSO. If an FCU accounts for its CUSO using the cost method consistent with Generally Accepted Accounting Principles (GAAP) and writes down the investment because of other than temporary impairment, the written down amount becomes the new basis and computes into the new aggregate cash outlay figure. If FCUs have questions calculating the aggregate cash outlay, they should contact their regional office for appropriate guidance.

Calculation of the CUSO funding limits is a separate issue from reporting CUSO investments and loans under GAAP. GAAP requires one of three measurement options—the cost method, equity method, or consolidated financial statements—depending upon the degree of ownership an FCU has in a CUSO. FCU financial reporting of CUSO activity should follow GAAP. The definition of ''paid-in and unimpaired capital and surplus'' is unchanged from the current definition in § 701.27(c)(4).

Parties

Recently a federally-insured credit union involved with a credit union service center CUSO applied to convert to a mutual savings and loan association. The board of directors of the converting credit union indicated that, after conversion, the savings and loan wanted to continue its participation in the credit union service center. If this had been permitted, it could have led to massive credit union member confusion when both NCUSIF and FDIC signs would be required to be posted together in service center locations. NCUA denied the institution the ability to proceed with this plan on the basis that a thrift could not participate in a ''credit union service center.'' However, NCUA wants to clarify this issue further in this final rule. The FCU Act prohibits a CUSO from being involved with non-credit union depository institutions, and this prohibition is reiterated in § 712.6(a). NCUA's position is that any intermingling of bank, thrift, and credit union share, deposit, or loan accounts at a CUSO credit union service center location is impermissible. To clarify this prohibition, NCUA has changed the phrase ''non-credit union parties'' to ''non-depository institution parties not otherwise prohibited by § 712.6 of this part.'' By stressing the impermissibility of depository institution involvement in CUSOs, and cross-referencing the statutory prohibition on certain parties' involvement in CUSOs, the Board intends to prevent impermissible party involvement in CUSOs. In addition, to prevent credit union member confusion, prevent unsafe and unsound activities, and provide notice and comment for non-CUSO credit union service centers, NCUA staff plans to study credit union service center activities for possible future Board consideration.

Section 712.3, What are the Characteristics of and What Requirements Apply to CUSOs?

Structure

NCUA proposed the addition of the limited liability company (LLC) format to the two existing permissible CUSO entity structures of corporation and limited partnership. When the new corporate rules become effective, corporate credit unions will be allowed to use LLC format CUSOs. 12 CFR 704.11. Thirty-nine of the 50 comments addressing LLCs favored the addition of LLCs. Many of these commenters noted that NCUA's concerns of a lack of standardized state laws and tax treatment of LLCs could be handled by appropriate legal, accounting, and tax advisors. In addressing NCUA's concerns, comments stated that: (1) the IRS did not issue hypothetical opinions and, therefore, it was not possible to obtain an IRS ruling unless and until NCUA permitted use of the LLC format; (2) LLC members withdrawing their capital can be restricted under an LLC agreement or a buy/sell agreement providing liquidity protections; (3) voting rights and powers of LLC members can be changed by the organization articles or by operating agreement; (4) limitations on LLC management transferability are little different from those applying to limited partnerships; and (5) state laws on corporations and limited partnerships also vary widely, and yet NCUA has not experienced any difficulties with state law variations regarding those formats. Commenters also noted that, by requiring an FCU to obtain written legal advice prior to investing in a CUSO formed as an LLC, NCUA could confirm that the laws of a particular state would insulate an FCU from liability as well as the older permissible corporation and limited partnership formats. This is the approach adopted by the Board in adopting LLCs as an additional permissible CUSO structure. In order for an FCU to invest in, or loan to, a CUSO structured as a LLC, the FCU must obtain written legal advice that the LLC is a recognized legal entity under the applicable laws of the state of formation and that the LLC is established in a manner that will limit potential exposure of the FCU to no more than the amount of funds invested in, or loaned to, the CUSO. Investing FCUs also must comply with the legal opinion requirements of § 712.4(b).

Comments opposed to LLCs believed that the LLC format was not needed in light of the existing corporation and limited partnership formats and the ability of CUSOs to make various taxation choices, such as the Subchapter S or cooperative tax elections. However, one of the purposes of this rulemaking was to give greater flexibility to CUSOs, and the majority of commenters approved adding LLCs with the legal opinion caveat.

The addition of the LLC format does not change NCUA's policy regarding multiple CUSOs. NCUA stresses that the CUSO rule applies to all levels or tiers of a CUSO's structure. In other words, all tiers of a CUSO, no matter what corporate format is used, are also CUSOs subject to part 712.

Customer Base

Twenty-four out of the 30 comments addressing the issue agreed that NCUA should *not* give a safe harbor definition of the meaning of ''primarily serves'' in the customer base requirement. Those in favor of a brightline definition believed that it would be useful, but could not agree on what the standard should be. In the past, NCUA's definition of the term ''primarily serves'' has depended upon several variables, such 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. Since CUSO permissible services and activities vary so much by business, and

since many CUSOs are engaged in multiple permissible services and activities, coming to a simple standard applicable to all lines of business and all CUSOs is problematic. In the 1986 final CUSO rule preamble, the Board stated that defining the term as a percentage of business or percentage of customers could prove arbitrary.

The Board is convinced by the comments that, if anything, defining the term ''primarily serves'' is even more difficult than in 1986, and declines to do so. NCUA will continue to monitor the customer base requirement on a case-by-case basis using a totality of the circumstances test.

One comment stated that NCUA should determine whether a CUSO ''primarily serves'' only at the time an FCU investment or loan is made to a CUSO and *not* revisit the test again thereafter. This is contrary to long-standing NCUA policy. The Board, as required by statute, must vigilantly reassess the customer base requirement on a constant basis. To do otherwise would permit a large loophole in the CUSO rule, allowing negligent or unscrupulous CUSOs to ignore the customer base requirements once fully funded from FCUs. This practice could easily lead to safety and soundness problems, and perhaps even threaten the NCUSIF. The Board disagrees with the comment and declines to change its position.

As previously discussed in the Supplementary Information under § 712.1, in lieu of using the term ''affiliated credit union,'' the Board has opted to restate the customer base requirement. CUSOs must primarily serve credit unions in a corporate capacity (e.g., check processing, data processing, or supervisory committee audits), or the natural person membership of those FCUs or FISCUs investing in, or lending to, the CUSO, or the membership of FCUs and FISCUs contracting with the CUSO. Any services provided to any entities or persons outside of this scope will be considered services to others which cannot be counted towards the CUSO's credit union customer base requirement.

NCUA also requested comments on CUSO activities, such as ATM services, that began as a service primarily to credit unions, but as a result of ATM network and switch consolidations, arguably no longer meet the CUSO rule ''primarily serves'' customer base requirements. In some of these situations, it is NCUA's understanding that an institution must hold stock in the ATM network or switch to participate in the ATM network or switch provider. NCUA does not want to deny credit union members ATM services due to a rule restriction. All eight of the comments addressing this subject stated that NCUA should allow CUSOs to buy and hold stock necessary to provide permissible services. To do otherwise might have serious long-term effects on the abilities of FCUs and CUSOs to compete, which could eventually erode the long-term financial conditions and generate safety and soundness concerns. To prevent these negative outcomes and promote regulatory flexibility, the Board has added a sentence to § 712.3(b). If it is necessary for an CUSO to purchase a minimum amount of stock to provide a permissible service, the purchase of the stock will not violate the customer base requirement so long as the other requirements of the CUSO rule are met.

NCUA wants CUSOs to understand clearly that this provision does not give FCUs a right to purchase stock or securities in any company in any amount. CUSOs may purchase only the minimal amount of stock absolutely necessary for the CUSO to provide a permissible service. If a CUSO owns more than the minimal amount of stock necessary, NCUA will require divestment of any stock in excess of the nominal amount needed for service provision. CUSOs may not invest in stocks and securities for speculative purposes.

FCU and CUSO Accounting

After consideration of the comments, NCUA made a few changes to the wording of § 712.3(c), FCU accounting, and (d), CUSO accounting; audits and financial statements; NCUA access to books and records. The changes clarify NCUA's CUSO review authority and make the rule clearer and easier to follow.

Ten of the 12 comments addressing the issue asked NCUA to continue the requirement for a CPA audit for CUSOs. The two comments opposed to the CPA audit stated that it would be better handled as a business decision by the CUSO's management. After consideration of the comments, NCUA continues to hold that the current requirement for a CPA audit means an opinion audit of the financial statements, performed by an independent, licensed CPA, and nothing less. The audit must be an audit of the separate CUSO entity and not simply an audit of the FCU's financial statements prepared on a consolidated basis, unless the CUSO is a wholly-owned CUSO. The reason for this long-standing position is that all credit unions investing in the CUSO need to be aware of any potential risks in their CUSO. This clarification reflects current practice and policy.

In the proposal, NCUA asked for comments regarding the AICPA's Statement on Auditing Standards (SAS) No. 70, Reports on the Processing of Transactions by Service Organizations. Six of the 10 comments addressing SAS No. 70 approved of NCUA's position of not requiring SAS No. 70 reviews in the CUSO rule, but leaving it to the judgment of the CPA conducting the CUSO audit. Comments were concerned about adding significant costs to the CPA CUSO audit if the SAS No. 70 review was required. Four comments suggested that the reviews should be required to put CUSOs on notice that NCUA will expect a SAS No. 70 review when one is necessary under AICPA guidelines. After weighing the comments, NCUA retains its recommendation that a CPA performing an opinion audit of the financial statements of an FCU that uses a CUSO to process transactions consider the guidance in SAS No. 70 when planning and performing the audit. SAS No. 70 provides guidance when an FCU obtains either or both of the following services from a CUSO: (1) executing transactions and maintaining the related accountability; and (2) recording transactions and processing related data. The AICPA recommends SAS 70 reports be completed in CUSO trust companies that invest and hold assets for FCU employee benefit plans; CUSO mortgage bankers that service mortgages for FCUs; electronic data processing (EDP) service centers that process transactions and related data for FCUs; and other situations in which a CUSO develops, provides and maintains the software used by FCUs. The SAS 70 report on policies and procedures placed in operation and tests of operating effectiveness are crucial in keeping FCUs informed of internal control weaknesses of CUSOs performing core functions of the FCU.

Additionally, FCUs and CUSOs are reminded that CUSOs must follow GAAP for financial reporting purposes and FCUs must follow GAAP or alternative accepted regulatory accounting practices (RAP). Further, CUSOs must obtain audits consistent with generally accepted auditing standards (GAAS). NCUA interprets GAAP to mean compliance with standards of the Financial Accounting Standards Board (FASB) and related hierarchy, and GAAS to mean auditing standards issued by the American Institute of Certified Public Accountants (AICPA), unless otherwise determined by NCUA.

NCUA reminds FCUs and CUSOs that GAAP requires that entities (FCUs) holding a controlling financial interest, generally assumed at fifty percent or greater of the voting common stock, in another company (e.g., a CUSO) file consolidated financial statements with their subsidiary (e.g., CUSO). FCUs that do not control more than a 50% interest but that have the ability to exert significant influence, generally assumed at 20%–50% of the voting common stock of a CUSO, are advised to use the equity method of accounting. In both cases (consolidated financial statements and the equity method), inter-company transactions should be eliminated. While these specific requirements are not made a part of the final rule, they are required under GAAP. They are noted here because of their importance in representing the relationship between a CUSO and an FCU.

NCUA Access to CUSO Information

NCUA solicited comment on whether NCUA examination and supervision authority over CUSOs should be strengthened. Both the Office of Thrift Supervision (OTS), which charters and supervises federal savings associations, and the Office of the Comptroller of the Currency (OCC), which charters and supervises national banks, subject their regulated financial institutions' subsidiaries to examination and supervision ''in the same manner and to the same extent'' as the parent financial institution. 12 CFR 5.34(d)(3)(OCC) and 559.3(o)(OTS).

Commenters were also asked to address issues concerning a middle ground, such as requiring CUSOs to adhere contractually to any conditions in writing imposed upon their business by the NCUA. Currently, both OTS and OCC may impose conditions in writing upon the subsidiaries of their regulated financial institutions. 12 CFR 5.34(d)(4)(OCC) and 559.1(b)(OTS). Another possibility raised by NCUA was to consider strengthening the existing audit and reporting requirements further, or to require CUSOs to adopt specified policies, procedures, and other internal safety and soundness controls.

Sixty-five of the 70 commenters addressing the supervision issue stated that NCUA did not need additional examination authority. Many of these comments considered additional government regulation time-consuming, costly to both NCUA and to the CUSO, and obtrusive. Some comments said that NCUA staff did not have the expertise to supervise and examine the various types of for profit CUSO businesses. Several comments advised that a reliance on various legal, accounting, and tax professionals would be preferable to NCUA regulation. A few comments distinguished bank and thrift subsidiaries regulated by OCC and OTS from CUSOs, which have not been directly regulated by NCUA. For instance, both federal thrifts and national banks may invest more in their subsidiaries, and must have higher percentages of ownership than the FCU Act or current § 701.27 permit. Other comments held that it would be unfair to regulate CUSOs providing core services, but not other vendors providing the same services to FCUs. Comments in favor echoed NCUA's reasons in support of examination authority in the proposed rule preamble. Seven comments asked NCUA to require CUSOs to adopt internal safety and soundness controls.

After due consideration of the comments on the available options, the Board has decided to adopt modifications to paragraph (d)(3) of this section, clarifying that NCUA has access to CUSO books, records, and the ability to review CUSO internal controls. This authority ratifies existing NCUA CUSO review procedures and practices. Currently, NCUA examiners perform a CUSO review to determine the degree of risk the CUSO poses to investor, borrower, and customer credit unions. The examiner must assess the financial condition of the CUSO, verify the accuracy of the financial statements, assess the adequacy of controls, determine the viability of operations and service to member credit unions, and confirm compliance with applicable laws and regulations. In the course of the CUSO review, the examiner may arrange to review records such as the CUSO's policies, procedures, budgets, business plan, goals and objectives, CPA opinion audit and related workpapers, general ledger, attorney opinions, reporting processes, board minutes, investment and loan documents, personnel documents, organization documents, and bylaws. The examiner may discuss with CUSO management the nature and extent of managerial planning, the overall reasonableness of the business plan, and budgetary projections. An on-site CUSO review provides the examiner an opportunity to observe and ascertain management's ability to effectively direct and control the CUSO's operations. It is critical for examiners to be able to review books and records, interview staff, and observe practices and procedures to determine the CUSO's ability to meet its goals, objectives, and financial projections; analyze its prospects for future success; and assess the risk to credit unions.

NCUA believes that this approach enhances the current approach of a contractual access to CUSO books and records in several ways. The ability to review CUSO internal controls enables NCUA to assess CUSO safety and soundness more quickly. Enhanced CUSO review authority helps protect CUSOs and participating credit unions from concentration and operation risk. It will also enable NCUA to better protect the NCUSIF from potential FCU losses due to CUSO losses. Presently, NCUA's main recourse is to require FCUs to divest CUSO interests and loans. NCUA is also concerned that, if CUSOs perform critical, core functions [1] for credit unions, it could disastrously affect affiliated credit union services. For example, where member transactions flow through the CUSO, credit unions are at substantial risk of losing much more than the amount of their CUSO investment or loan. Credit unions could also lose operational capability, which could detrimentally affect member services.

NCUA believes that the enhanced CUSO review approach has few drawbacks. It is unlikely to be a factor a court could consider in piercing the corporate veil and imputing liability to a credit union investor or lender. NCUA

[1] As a point of beginning, NCUA considers the following a list of such critical, core services and activities: (1) *Share-related core services.* Data processing of share deposits, withdrawals, and other account transactions; Operations conducting member share transactions for credit unions, including service center branches, remote service operations and ATMs; Provision of share account related clerical, professional, or management services; Share draft and deposit posting, sorting, and processing; ACH services; Advertising, brokerage, and other services to procure and retain share accounts; Computation and posting of dividends and other credits and charges; Preparation and mailing of share drafts, statements, notices, and similar items; (2) *Credit-related core services.* Data processing of loan applications, evaluations, extensions, collections, and payments; Making, acquiring, servicing, warehousing or otherwise processing member loans or other extensions of credit for a credit union, including consumer loans, credit card loans, mortgage loans, student loans, business loans, and loan equivalents, such as leasing and indirect lending programs; Operations conducting lending activity for credit unions, including service center branches, remote service operations, ATMs, and loan production offices; Advertising, brokerage, and other services to procure and retain loans; Advising, structuring, and arranging extensions of credit; Provision of credit analysis services; Provision of credit account related clerical, professional, or management services; and (3) *Other related core services.* General ledger data processing; Auditing and accounting; Management, development, sale or lease of affiliated credit union fixed assets; Record retention, security, and disaster recovery services; Provision of investment advice, counseling, or services; Provision of liquidity management, investment, advisory, and consulting services; Development and administration of personnel benefit programs, including life insurance, health insurance, and pension and retirement plans.

examiners are well qualified by experience and training to conduct CUSO reviews. While NCUA encourages CUSOs to use professional legal, accounting, and other services when needed, the Board believes that, in certain cases, a CUSO review conducted by an examiner best meets NCUA's needs. The current CUSO review, which is consensually scheduled, is specifically designed to result in minimal burden upon CUSOs. CUSO review authority is especially crucial in light of NCUA's extensive Year 2000 compliance program.

NCUA's Year 2000 compliance program necessitates extensive cooperation between data processor entities, credit unions, and the NCUA if it is to accomplish its goals in the available time remaining. The enhanced review authority ensures this cooperation between NCUA and CUSOs engaging in data processing activities. NCUA does not intend to use its right of access to CUSO information to roll out a comprehensive CUSO review program. NCUA plans to continue to use CUSO reviews sparingly, usually when a potential systemic risk is present, as with the Year 2000 compliance program, or when other facts and circumstances raise operational, concentration, or financial risk issues that might detrimentally affect credit unions and their members.

The NCUA Board considers the requirements set forth in the rule to be necessary for the safety and soundness of FCUs and ultimately the NCUSIF. The Board believes that it has properly exercised its authority in preserving access to CUSO information. Section 204(a) of the FCU Act, 12 USC 1784(a), authorizes the NCUA Board to examine any insured credit union. Examiners are authorized to ''make a thorough examination of all the affairs of the credit union.'' Section 204(b) of the FCU Act, 12 USC 1784(b), further authorizes the NCUA Board or its representatives to ''take and preserve testimony under oath as to *any matter in respect to the affairs of any such [insured credit union],* and to issue subpoenas and subpoenas duces tecum.'' [Emphasis added.] Such subpoenas are to be enforced by the United States District Court ''where the *principal office* of the credit union is located or *in which the witness* resides or *carries on business.*'' [Emphasis added.]

It is clear that FCU investments in and loans to CUSOs are matters within the ''affairs of the credit union.'' Under §§ 204(a) and (b) of the FCU Act, NCUA is authorized to examine such credit union affairs and, if testimony and records cannot be obtained through such examination, to issue subpoenas and subpoenas duces tecum. This authority extends to those individuals and entities that are involved with insured credit unions, as evidenced by the reference to ''principal office . . . in which the witness . . . carries on business'' in § 204(b). Therefore, under the Board's authority to promulgate regulations, examine insured credit unions, and issue subpoenas and subpoenas duces tecum, the Board has the authority to require the FCUs that invest in or lend to a CUSO to obtain a written agreement granting NCUA access to CUSO information. 12 USC 1766(a) and 1789(a)(11). Creditor and investor FCUs in CUSOs are advised to obtain amendments to their required, written agreements with CUSOs as soon as possible. FCUs will have until December 31, 1998, to obtain the revised agreements with their CUSOs. The Board believes that the delayed effective date of December 31, 1998, which is ten months from the date of the adoption of the new rule, will give all FCUs sufficient time to obtain revised CUSO agreements in compliance with § 712.3(d).

Commenters were also requested to comment on whether NCUA should charge a review or examination fee for conducting CUSO examination activities. Thirty out of 36 comments opposed a fee contending it would financially burden CUSOs, many of which are start-up businesses, run at a loss, or disburse any profits back to their investor FCUs. The six in favor of a fee noted the reasons NCUA stated in the preamble: the need for more NCUA staff time; resultant increased agency expenses; and the fairness of charging users of NCUA examination services. After consideration of the comments, the Board has decided not to require a CUSO review or examination fee at this time. The Board believes that all credit unions and their members will benefit from the review of CUSOs, whether or not every FCU or FISCU uses the CUSOs reviewed. Therefore, it is more equitable to pay any of these costs out of the FCU operating fee and NCUSIF overhead transfer.

Compliance With Other Laws

This subsection remains unchanged from the proposal. NCUA has interpreted this requirement to apply, not only to laws applicable to the proper maintenance of either corporate or limited partnership format, such as fee, filing and tax requirements, but also to any other laws applicable to the nature of the CUSO's business. For instance, an insurance agency CUSO must comply with state insurance laws and regulations. Any CUSO that is a franchise would need to follow federal and state franchising laws. Any CUSO service center would need to follow all applicable federal consumer protection laws related to its activities, as well as other relevant laws applicable to FCUs, such as those relating to supervisory committee access (12 CFR 701.12–.13); loans to members (12 CFR 701.21); truth in savings (12 CFR Part 707); advertising (12 CFR Part 740); share insurance (12 CFR Part 745); security program, report of suspicious activity, and bank secrecy act compliance (12 CFR Part 748); records preservation and retention (12 CFR Part 749); and relevant bylaw requirements, such as those relating to the confidentiality of member records (Standard Federal Credit Union Bylaws, NCUA Publication No. 8001) .

Section 712.4, What Must an FCU and a CUSO do to Maintain Separate Corporate Identities?

Separate Corporate Existence

In the proposal, NCUA requested comment on the use of corporate separateness guidelines in § 712.4(a)(1–6), which, in turn, were based upon the OTS rules applicable to federal savings and loan service corporations. 12 CFR 559.10. Eight of the 14 comments were opposed to the addition of corporate separateness requirements. Several of these comments said that these principles addressing good business practices would be more appropriately included in NCUA guidance in a rule commentary rather than in the rule. Other comments stated that state law controlled whether the corporate veil would be pierced between a CUSO and an FCU and, therefore, the proposed corporate separateness guidance was not useful. The five comments in favor believed that the addition of the corporate separateness guidelines into the rule would better publicize guidance to all CUSOs, not all of which might read supplementary NCUA guidance presented in another format. One commenter asked that NCUA prohibit FCUs and CUSOs from sharing directors, and require a CUSO to disclose on its documents that it is a separate entity from any FCUs.

The Board has decided to include the guidelines, but clarify that the guidelines are merely evidence of good business practices reflecting corporate separateness. This way the guidelines could not be used to supersede any individual state's laws regarding imputed liability. The Board has not otherwise modified the guidelines from the proposal. Although NCUA does not

ban FCU/CUSO interlocked boards, NCUA cautions FCUs and CUSOs that interlocking boards are often a critical factor in a court piercing a corporate veil. Likewise, although NCUA will not require CUSOs to disclose in their documents that they are separate entities, NCUA strongly encourages CUSOs to do so as a prudent business practice, especially if the CUSO and any FCUs share similar names that might potentially cause credit union member and public confusion. This is often another critical factor in courts considering liability between two entities.

Legal Opinion

In the proposal, NCUA solicited comment on whether the legal opinion requirement should be expanded from requiring an opinion on the establishment of the CUSO to require additional legal opinions when the CUSO changes its structure, such as from a corporation to an LLC, or when the CUSO adds an additional permissible service. Sixteen of the 24 comments addressing this issue opposed these changes on grounds of regulatory burden. Some of these comments also thought the terms used in the proposal ''10% or greater equity interest'' and ''maintained'' needed more clarification. Eight of the comments favored expanding the legal opinion requirement to structure changes, but five of these opposed obtaining legal opinions when new permissible services were added to a pre-existing CUSO. These comments reasoned that there should be nothing inherently dangerous or speculative to an existing CUSO in adding an additional permissible service or activity related to the daily, routine operations of FCUs. One comment stressed that NCUA should clarify that it would require legal opinions *prior* to the establishment or structure change of a CUSO. A few comments asked that NCUA adopt the detailed legal opinion requirements provided for corporate CUSOs in § 704.11(b) to assist drafters and beneficiaries of the content of the required legal opinion.

Additionally, to reduce the regulatory burden of obtaining legal opinions, NCUA proposed that legal opinions will only be required for FCUs owning a 10% or greater equity interest in a CUSO. NCUA roughly estimated that such a limitation would reduce the number of legal opinions needed by as much as 80%. Sixteen out of the 28 comments addressing this issue favored requiring legal opinions only for FCUs holding a 10% or greater equity interest in a CUSO, giving regulatory relief as the reason. Comments opposed to the proposed measure either wanted the threshold raised, or the legal opinion requirement left as is.

After due consideration of the comments, NCUA has revised the legal opinion requirement in several respects. First, NCUA deletes the legal opinion requirement for an existing CUSO that adds new permissible services or activities. Second, NCUA clarifies that legal opinions for CUSO establishment and structure change are due before, and not after, the CUSO is established or changes its structure from one permissible form to another (e.g. from a corporation to an LLC). Third, NCUA adds additional guidance on the content of the required legal opinions, which it borrows from § 704.11(b). Fourth, NCUA clarifies that all investing FCUs, regardless of their percentage of equity ownership, must obtain required legal opinions. FCUs lending to CUSOs should be protected from losses by following their usual credit policies. However, the risk is greater for FCUs investing in CUSOs. Limiting the legal opinion only to those FCUs with ''10% equity interest'' exposes smaller CUSO equity holders, who arguably need the assurances supplied by a legal opinion more than larger CUSO equity holders, to more of a potential risk due to defects in CUSO formation. By eliminating the legal opinion requirement for creditor FCUs, the Board remains able to provide a significant reduction in an FCU's paperwork burden. Fifth, NCUA clarifies that the legal opinion may be provided by independent legal counsel either of the investing FCU or of the CUSO. Currently, often the attorney for the CUSO, who actually performs the legal work creating the CUSO, provides the required legal opinion to participating CUSOs. The rule clarification sanctions this practice.

NCUA believes these changes will help strengthen corporate separateness, provide clear guidelines for compliance, and provide continuing guidance during the life of the CUSO without the drawbacks of the current legal opinion requirement. NCUA encourages legal, accounting, tax advisor, and other consultant involvement in matters affecting CUSO investments and loans. The changes in the final rule to the legal opinion requirement will aid FCUs in ensuring CUSOs are properly formed and given advice on how to function under state law in order to avoid imputed liability from a CUSO to an FCU.

Section 712.5, What Activities and Services are Preapproved for CUSOs?

General

NCUA solicited comment on a proposed provision which reserved to NCUA the right to limit any CUSO's activities or to refuse to permit activities for supervisory, legal, or safety and soundness reasons. The provision was derived from OCC and OTS subsidiary requirements (12 CFR 5.34(d)(3) and 559.1(b)). All of the eight comments addressing the issue were opposed. These comments stated that the sentence was ambiguous, burdensome, and unnecessary in light of NCUA's divestment authority. One comment suggesting that NCUA could achieve its intent by rephrasing the sentence to state that NCUA could limit an FCU's loan or investment in a CUSO or refuse to approve new CUSO activities under § 712.7.

NCUA disagrees with the commenters and adopts a slightly modified version of the proposal, reordering the words without changing content. NCUA sees the sentence as a clarification of existing NCUA practice, and as necessary given NCUA's decision to enhance CUSO review authority in § 712.3(d)(3). Currently, NCUA provides interpretations of the limits of existing permissible CUSO activities through the issuance of legal opinion letters and regional and central office correspondence. As the proposed amendment provides, these current NCUA pronouncements are based upon examination, legal, and safety and soundness grounds. The provision puts FCUs and CUSOs on notice that NCUA does have the right to interpret the limits of permissible CUSO services and activities. If transgressions are discovered after the fact, NCUA will work with the credit unions and CUSOs involved to arrive at a mutually satisfactory conclusion through the CUSO review and available enforcement processes. In an extreme case, NCUA can order the affiliated credit union to divest its CUSO investment or dispose of its CUSO loan or use other enforcement tools at its disposal against the FCU, such as prohibitions, removal orders, cease-and-desist orders, or civil money penalties. NCUA may also exercise these remedies against the FCU if the normally permissible CUSO services and activities are improperly, imprudently, or recklessly conducted.

A few comments asked that NCUA add the word ''only'' to the last sentence of the introduction to § 712.5 so that the phrase would read that CUSOs can ''only provide one or more of the following activities and services.'' The

purpose of this change, derived from current § 701.27(d)(5), would be to clarify that the permissible activity and service list is exclusive, in other words, services that are not on the list cannot be performed by a CUSO. The Board agrees with this comment and makes this change in the final rule. However, the Board would like to point out that parties can use § 712.7 to petition the Board for additional activities or services not already listed in § 712.5.

Insurance and Bonding

In the proposal, NCUA solicited comment on whether an insurance or bonding requirement should be imposed upon CUSOs. Of the 33 comments addressing this issue, 23 stated that insurance and bonding decisions should be left as a management decision of the CUSO, consistent with any state requirements. The 10 comments supporting the insurance and bonding requirement believed insurance or bonding was a good business decision that helped to protect investor, borrower, and contracting FCUs from any CUSO liability. A few comments stressed that a CUSO fidelity bond or basic commercial crime insurance coverage could be especially critical to service center CUSOs and other CUSOs providing core services to FCUs. One commenter asked that NCUA provide flexibility and not require any types of coverage not available to CUSOs in the marketplace, mentioning that one major mutual insurance company no longer sold CUSO endorsements on its credit union bonds.

After considering the comments, the Board decided to add a requirement that all CUSOs be ''sufficiently bonded or insured for their specific operations.'' Because a major mutual insurance company commented that it does not consider the credit union fidelity bond to cover CUSO activities and services, the Board believes it should address CUSO insurance in the rule. Comments confirmed the insurance industry makes a wide variety of insurance products available to CUSOs that are similar to the FCU fidelity bond in coverage. A basic Commercial Crime Policy can include coverage for employee dishonesty, theft, disappearance and destruction, and depositor's forgery.

Similarly, mortgage service CUSOs generally must have a bond meeting secondary mortgage market requirements, such as a Financial Institutions Bond Standard Form No. 15 (Mortgage Bankers Blanket Bond Policy). Likewise, a securities brokerage CUSO often will be a member of the National Association of Securities Dealers (NASD), and will meet NASD bonding requirements through a Financial Institutions Bond Standard Form No. 14 (Security Brokers Blanket Bond). Although some of these coverages may be required by other state or federal laws, the Board strongly believes that in order to protect FCUs and credit union members served by CUSOs that CUSOs must maintain business insurance adequate to meet the CUSO's needs as determined by each CUSO's board of directors and management, and as verified by NCUA staff. This regulatory language will protect FCUs that receive CUSO services and provide flexibility for CUSOs to choose the best insurance or bonding option available for the particular services and activities conducted by them. CUSOs are encouraged to analyze their insurance needs whenever adding a new service or activity, changing their structure, or, in any event at least on an annual basis.

Permissible Activities and Services

CUSOs, according to the FCU Act, are to provide ''services which are associated with the routine operations of credit unions.'' 12 U.S.C. 1757(7)(I). In addition, CUSOs are to be ''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.'' 12 U.S.C. 1757(5)(B). In providing these daily, routine services of need to credit unions, CUSOs must avoid investments in depository financial institutions, insurance companies, trade associations, liquidity facilities, and similar entities. 12 U.S.C. 1757(7)(I). In the past, NCUA has interpreted this statutory authority broadly to encompass most services and activities a credit union can provide to itself and its members through use of express authority, incidental authority, or goodwill authority. NCUA feels this interpretation is supported by the language of the FCU Act, which sets forth a clear boundary of CUSO services, namely, services fulfilling credit union and credit union member needs. Congress did not choose to limit CUSO activities by cross-reference to statutory FCU powers or by specifically listing CUSO powers in the statute. This background on NCUA's CUSO policy is germane to the following discussion of permissible CUSO powers.

Eight new services, reflecting current NCUA interpretations of existing services, were contained in the proposed rule. First, in proposed paragraph (a)(3), under checking and currency services, NCUA proposed to add ''money order, savings bonds, travelers checks, and purchase and sale of U.S. Mint commemorative coins services.'' Second, in proposed paragraph (b)(2), under clerical, professional and management services, NCUA proposed to add ''courier services.'' Third, in proposed paragraph (b)(4), also under clerical, professional and management services, NCUA proposed to add ''facsimile transmissions and copying services.'' Fourth, in proposed paragraph (b)(10), also under clerical, professional and management services, NCUA proposed to add ''supervisory committee audits.'' Fifth, in proposed paragraph (d)(5), under electronic transaction services, NCUA proposed to add ''electronic income tax filing.'' Sixth, in proposed paragraph (h)(2), under leasing, NCUA proposed to add ''real estate leasing of excess CUSO property.'' This covers real estate leasing only of premises acquired for CUSO business, and otherwise mainly used in CUSO business, that may later be used for future CUSO expansion. CUSOs are still otherwise obligated to demonstrate that the purchase of any real property will be used for CUSO purposes. NCUA expects that any real property purchased by a CUSO for future expansion should have a future benefit to the CUSO as evidenced by a business plan discussing future use of the real property. Although ''personal property leasing'' and ''real estate leasing of excess CUSO property'' are listed as the only two permissible leasing services in proposed paragraph (h), fixed asset leasing is also permitted, but retained with the other permissible fixed asset activities in proposed paragraph (f)(1). Seventh, in proposed paragraph (j)(2), under record retention, security, and disaster recovery services, NCUA proposed to add ''disaster recovery services.'' Eighth, in proposed paragraph (j)(3), also under record retention, security and disaster recovery services, NCUA proposed to add ''optical imaging, CD-ROM data storage and retrieval services'' to current ''microfilm and microfiche services.'' Thirty-two of the 33 comments addressing this issue agreed that all eight services should be added to the rule for the reasons NCUA expressed in the proposed rule. The one opposing commenter gave no explanation for her position. The Board, finding that these services are self-explanatory and only codify existing permissible services and activities not currently in the rule itself, adopts them in the final rule.

NCUA also solicited comments on whether to add consumer loan originations to the list of permissible activities. Thirty of the 39 comments addressing this issue desired addition of

consumer loan origination authority. Some of these comments stated that the authority would enable FCUs to seek out new sources for loans, help increase FCU growth, avoid predatory dealer financing practices on members, be more efficient, allow FCUs to make riskier loans through the CUSO, help reduce funding risk by facilitating use of secondary market packaged loans, and would otherwise complement an FCU's lending program. Two comments specifically asked for student loan origination authority, as an analog to the already approved consumer mortgage loan authority. Student lending is technical, complex, staff-intensive, heavily regulated by government, and involves dealing with universities, students, specialized processors, and various branches of local, state, and federal government. Nine comments opposed consumer loan origination based on the opinion of the commenters that consumer loan activity was beyond NCUA's statutory authority to approve, would dilute an FCU's common bond requirements, and would take the lending decision away from credit union board of directors.

Comments were also solicited on whether consumer loan origination services would be helpful to small, low-income, or community development credit unions. Commenters were asked to address whether consumer loan services should be permissible only for credit unions of a certain asset size and how such a class should be defined. Of the 11 comments received on this issue, 6 supported consumer loan origination authority for small credit unions and 5 opposed. The reasons given were similar to those used in support of, and opposition to, general consumer loan origination authority. NCUA received no suggestions as to how to define the applicable group of small credit unions.

After due consideration of the comments, NCUA remains opposed to this addition. Unlike consumer mortgage loan origination, which requires a specialized lending staff, must follow strict secondary mortgage market rules, and requires economies of scale in order to be viable, consumer loans are relatively easy to offer and process. In addition, NCUA is apprehensive in granting CUSOs the 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. However, the Board is inclined to approve the addition of student loan origination to the list. Like consumer mortgage loan origination authority, in order to be properly performed in a competitive manner within applicable laws, student loan operations can greatly benefit from specialized staff familiar with this complicated, specialized form of lending. Like mortgages, student loans also readily lend themselves to packaging and sales. It is already permissible for CUSOs to engage in loan processing, servicing, sales, and collections. Combining these pre-existing authorities with student loan origination authority should enable FCUs and FISCUs to become more involved with student lending.

NCUA also stresses that while CUSOs can only approve and fund consumer mortgages and student loans, CUSOs can engage in many back office aspects of lending. CUSOs can provide loan support services, such as loan processing, servicing and sales, as well as debt collection and collateral repossession services. The FCU, however, must make the decision whether or not to grant the loan in accordance with the FCU's loan policies. In essence, CUSOs can provide back office underwriting, processing and servicing functions to enable a credit union to offer loans. In addition, if a CUSO has lending personnel on its staff involved in making and administering business loans with a minimum of 2 years direct experience with lending, then FCUs using the CUSO for back office business loan functions can use the CUSO's staff to fulfill its obligation to have an experienced lender on the FCU's staff, as is required by § 701.21(h)(2)(i)(F). In other words, FCUs are permitted to leverage their member business loan expertise with CUSO business loan personnel. This clarification is made to assist FCUs in expanding the number and type of business loans made to its members in conjunction with the member business loan amendments proposed in 62 FR 41313 (August 1, 1997).

In the proposed rule, NCUA solicited comment on whether three services currently permissible for CUSOs should remain permissible: (1) data processing services to the general public; (2) travel-related services; and (3) real estate brokerage services. Thirty-five of 36 comments addressing the issue favored the retention of data processing services to the general public. Comments stated that other federal financial institution regulators were considering changing their rules to allow these data processing services and providing services to others helped pay for data processing computer equipment and services and helped keep costs down. Similarly, 35 of 36 comments addressing the issue favored the retention of travel-related services. Comments stated that travel-related services had been traditionally provided in FCUs for many years and helped to promote thrift in the form of vacation share savings accounts and promote lending in the form of vacation loans. The single comment opposing the retention of data processing services and travel-related services was based on the grounds that the service is impermissible and legally insupportable. NCUA disagrees with this one comment on the grounds that the Board has constructed an adequate administrative record to support the inclusion of these services within the context of the CUSO rule, based upon the Board's statutory authority and the Administrative Procedure Act. Therefore, the Board will retain data processing services and travel-related services in the CUSO rule.

All 26 comments addressing the issue favored the retention of real estate brokerage services. Comments stated that the service was complementary to FCU and FISCU mortgage loan operations and programs. Despite the comments, NCUA has been troubled by cases involving conflicts and the appearance of conflicts between real estate brokerage CUSOs and the credit unions such CUSOs serve. In one instance, the NCUSIF suffered a large loss due to a real estate brokerage service, and several FCUs and FISCUs have suffered losses due to conflicts arising between the credit union and a real estate brokerage. Because of these concerns, the Board has decided to remove ''real estate brokerage services'' from the list of permissible CUSO activities and services. This removal is set forth in § 712.6(b). However, CUSOs with current investments or loans to real estate brokerage service CUSOs as of the effective date of this rule will be allowed to continue to offer the service under a 3 year grandfather provision under § 712.9. For similar reasons regarding impairment of appraiser independence and possible conflicts of interest, the Board declines to add real estate appraisal activities in the list of permissible activities.

NCUA also requested comments regarding any aspects of any other currently allowable, or potentially allowable, CUSO activity or service. One comment suggested adding ''electronic imaging'' to the list of record retention imaging services listed under the ''Record Retention, security and disaster recovery services'' category to cover future imaging technologies. The Board adopts this comment in the final rule.

Another comment asked that NCUA permit business lending services,

certificate of deposit brokerage services, medical savings accounts, telemarketing services, EFT services (point of sale, remote banking, and smart cards), executive/private banking services and correspondent banking services including cash letter processing and remittance lock box services. Some of these services can be provided under current authority: CD brokerage services can be provided by a securities brokerage CUSO; telemarketing is a form of permissible marketing services; the EFT services seem permissible; and it is possible that some of the other services, other than business lending, could be provided by a trust company CUSO. Member business loan origination is rejected for the same reasons described under consumer loan origination. Without more detail on these suggested services, the Board declines to add any of them to the permissible activities and services list at this time.

One comment suggested changing the heading of paragraph (g) from ''Insurance brokerage or agency'' to ''Providing group purchasing programs.'' The comment stated that in some states the subsidiary of a financial institution cannot be licensed as an insurance brokerage or agency, but the financial institution may still want to make available to their members a legal insurance product, such as mortgage life insurance. The comment contemplated various insurance group purchasing programs, such as vehicle warranty programs, home warranties, gap insurance (protects any gap between the original cost of a vehicle and the actual cash value in the event the vehicle is destroyed), debt cancellation programs, and motor club programs. The Board is of the opinion that the addition of ''provision of group purchasing programs'' under the existing category ''(g) Insurance brokerage or agency'' is sufficient to allow CUSOs to engage in the contemplated programs. The CUSO rule does not preempt state licensing laws, therefore, it is beyond NCUA's authority to permit CUSOs, which must be properly established and operated under applicable state law, to offer or provide a service or product that is impermissible under state law. In addition, the Board is wary of how others would treat the potentially broad, vague, and troubling category of ''group purchasing programs'' without limiting it in some fashion, as the Board has done here, by limiting it to insurance-type group purchasing services.

One comment recommended that paragraph (d), ''electronic transaction services,'' be expanded to include electronic payment systems, such as stored value cards, e-cash, e-checks, and any other developing or emerging technology through which financial services may be delivered. Another comment suggested that paragraph (d) should be renamed ''electronic currency and electronic delivery systems'' to include electronic payment systems to permit the delivery of financial services, transactions and value, including stored value cards, e-cash, e-checks, stamps, coupons or similar payment forms; and that paragraph (d)(3), ''data processing,'' be renamed ''data processing and multi-media communication and information systems'' to facilitate delivery of financial services through emerging and future technologies such as smart phones, interactive televisions, video screens and terminals, electronic conferencing centers, automated video financial centers, and digital signature certification centers, and to also act as Internet service providers. The Board indicates its approval of services that are currently performed in a credit union branch, but can now be performed by computer-based means, by adding the term ''Cyber financial services'' as new paragraph (d)(8) to the permissible services list. The Board cautions CUSOs that permissible CUSO ''Cyber financial services'' only includes credit union member financial services that are analogous to services performed for credit union members in a credit union branch and not unrelated services.

A few comments asked that NCUA provide a list of impermissible activities and allow anything not on that list to be permissible. Other comments asked that NCUA let the board of directors of each CUSO decide what services to offer instead of providing a list of permissible activities and services. The Board believes that it is better to have a list of permissible activities and services than either no list or a list of impermissible activities and services. A permissible activities and services list is easier to administer, more familiar to users, and is less likely to be misinterpreted. Therefore, the Board declines to adopt these comments' proposals.

To summarize, the proposed rearrangement of the list of permissible activities and services has been adopted with a few changes based upon comments received and staff investigation. First, ''Cyber financial services'' has been added as new paragraph (d)(8) to the category of ''Electronic transaction services.'' Second, ''Provision of group purchasing programs'' is added as new paragraph (g)(3) to the category of ''Insurance brokerage or agency.'' Third, the category ''Real estate brokerage services'' is removed. Fourth, ''electronic imaging'' is added to the list of record retention imaging services listed under the new paragraph ''(j) Record Retention, security and disaster recovery services.'' Fifth, a new category, ''Student loan origination'' is added as new paragraph (m). Sixth, all eight proposed rule services and activities have been added, and data processing and travel services have been retained as permissible CUSO services.

The Board adopts the rearrangement of the list of permissible activities and services for ease of understanding and citation, to reflect changes in CUSO activities and services, and to provide flexibility for future CUSO growth. The final categories of permissible services and activities are as follows: checking and currency services; clerical, professional and management services; consumer mortgage loan origination; electronic transaction services; financial counseling services; fixed asset services; insurance brokerage or agency; leasing; loan support services; record retention, security and disaster recovery services; securities brokerage services; shared credit union branch (service center) services; student loan origination; travel agency services; and trust and trust-related services. The category headings are solely descriptive in nature and not meant to convey authority for additional services and activities beyond the specific services and activities listed.

Section 712.6, What Activities and Services are Prohibited for CUSOs?

The proposed section rephrased the statutory prohibition of 12 U.S.C. 1757(7)(I). The four comments addressing this section opposed the proposed wording. Comments found the rephrasing vague, ambiguous and not supported by the statute. Comments pointed out that the statute did not prohibit insurance company involvement with CUSOs and found NCUA's prior policy prohibiting insurance company involvement to be unfounded, unnecessary, and insupportable under the statute. After further review, the Board agrees and has reworded this section to follow the language used in the statute verbatim.

In addition, as discussed under the supplementary information for § 712.5, Permissible Services, a new paragraph (b) has been added to set forth that any new FCU investments or loans in a CUSO involved with real estate brokerage services cannot be made after April 1, 1998, and any existing investments or loans must be phased-out over a three year period as provided in § 712.9.

Section 712.7, What Must an FCU Do To Add Activities or Services That are Not Preapproved?

The comments addressing this section agreed that it is useful to have a regulatory mechanism to add unpreapproved activities and services under an expedited 60-day consideration time frame. This would allow Board consideration of potential CUSO activities and services that are not included in the permissible CUSO activities and services list in § 712.5. The proposed language is adopted as revised for plain language reasons previously discussed in this Supplementary Information. The terms ''NCUA Board,'' and ''Secretary of the Board,'' have the meanings ascribed to them in Part 790 of the NCUA Rules and Regulations. 12 CFR Part 790.

Section 712.8, What Transaction and Compensation Limits Might Apply to Individuals Related to Both an FCU and a CUSO?

Conflict of Interest

NCUA requested comments on means to enable NCUA to better police potential CUSO/FCU conflicts, including NCUA's proposal to eliminate the ability of a CUSO to reimburse an FCU for the services of the FCU's officials and senior management employees. Seventy-one of the 72 comments received on this issue opposed NCUA's proposed reimbursement prohibition. Many comments stated that this one factor would not be controlling to a court in determining whether or not to pierce the corporate veil to find an FCU liable for acts or omissions of a CUSO. Other comments stated that a prohibition would have the effect of severely hampering, if not making it nearly impossible, for small and start-up CUSOs, that could not otherwise afford to pay for non-credit union employees, to function. Some comments stressed that shared employees were helpful in maintaining communication between an FCU and a CUSO, which aided in furthering their shared mission of providing member services. Many comments stated that for profit, taxable CUSOs are eligible for a tax deduction for business expenses for reimbursements made to an FCU on account of shared employees, while dividends are not deductible. One comment suggested that NCUA should encourage prudent management by requiring arms' length transactions through means of required contractual agreements. Several comments stressed that the reimbursement does not by itself raise concerns. It is the actions of a few individuals that cause NCUA concerns, and these individuals should be handled by increasing implementation of NCUA fraud detection programs and policies. Comments stated that the combined effect of the proposed ban would be to prevent formation of new CUSOs, impede expansion of CUSO services to other credit unions, and jeopardize the operations and finances of existing CUSOs. In sum, elimination of the ability to reimburse would seriously hinder CUSOs' ability to perform and deprive credit union members of additional revenues and services.

Many of the comments clarified for NCUA the extent and nature of FCU services used by CUSOs: facilities (space, utilities, maintenance services, and janitorial services); systems support (telephone, computer, Internet access); shared employees and staff (accounting, human resources, call center, marketing) and direct services like attorney and advertising services. After gaining a better understanding of the CUSO industry through due consideration of the comments, the Board has decided to continue to allow CUSOs to reimburse FCUs for the services of FCU officials, senior management employees, and employees under one condition. The condition is that the FCU accounts payable, due from the CUSO on account of the CUSO's use of FCU officials, senior management employees, and employees, must be cleared and paid in full at least every 120 days. NCUA has experienced a recurring problem of CUSO nonpayment of the funds owed to the FCU on account of the CUSO's use of FCU officials and employees. In several cases, the account receivable due from the CUSO has been allowed to accumulate for several years, triggering safety and soundness issues. In some of these cases, the FCU has been unable to collect the accumulated account receivable from the CUSO resulting in a write-down of the account receivable as an impaired asset. This practice threatens the safety and soundness of FCUs and the NCUSIF. Examiners will be instructed to review the accounts receivable due from CUSOs to ensure compliance with this requirement after this rule becomes effective.

The primary purpose of the conflict of interest section is to prevent insider abuse and self-dealing that could lead to losses at the CUSO, affiliated credit unions, and the NCUSIF. It is the responsibility and fiduciary duty of FCU volunteers and employees to make decisions based on the best interests of the FCU and its members. Motivations of personal financial gain from CUSO activities could present an inherent conflict of interest. Such motivations in various CUSO cases have led to personal gain by FCU officials and resulted in FCU losses, occasionally even resulting in the liquidation or merger of the FCU. In addition, CUSO compensation of FCU volunteers could serve as a means to subvert the prohibitions on compensation for volunteer officials contained in the FCU Act. 12 U.S.C. 1761 and 1761a. Moreover, compensation of shared CUSO/FCU officials might be a factor that a court could evaluate in deciding to pierce the corporate veil to impute liability from a CUSO to an FCU. For these reasons, NCUA is committed to maintaining strong conflicts of interest provisions for CUSOs and FCUs.

FCU officials and employees, and their immediate family members, who also work in CUSOs engaging in FCU loan-related services, should be careful to comply with 12 CFR § 701.21(c)(8), NCUA's loan conflicts rule. Individual compensation related to FCU loans can trigger application of the loan conflicts rule. CUSO loan-related services include loan support services, such as debt collection services; loan processing, servicing and sales; or the sale of repossessed collateral; as well as leasing, consumer mortgage loan, or student loan origination activities.

Section 712.9, When Must You Begin Compliance With the Revised Rule?

NCUA solicited comment on when FCUs and CUSOs should begin compliance with a revised final part 712. The few comments received on this issue varied from the effective date to 6 months to 9 months to 1 year. After consideration of these comments, and in light of the few changes to the CUSO rule, the Board is adopting the April 1, 1998, effective date as the compliance date, as it proposed. Any conversion compliance problems should be brought to the attention of the appropriate NCUA Region immediately upon discovery for expeditious handling and resolution. FCUs will have three years, until April 1, 2001, to divest or close-out any nonconforming investments or loans made nonconforming by this new rule, such as FCU investments in, and loans to, CUSOs engaging in real estate brokerage services.

Section 740.3(c), Mandatory Requirements With Regard to the Official Sign and Its Display

Federally-insured credit unions are not permitted to receive account funds at any teller's station or window where any non-federally insured credit union or institution receives shares or deposits. Credit union service centers

and branches servicing more than one credit union where only some of the credit unions are insured by NCUA are currently exempt from this requirement. However, in a service center context a sign is required immediately above or beside each official NCUA sign stating ''Only the following credit unions serviced by the facility are federally insured by the NCUA _____.'' (The full name of each credit union insured is to follow the word NCUA). The lettering is to be of such size and print to be clearly legible to all members conducting share or deposit transactions. The intent of this requirement was to inform credit union members using a service center that share insurance was dependent upon their credit union and not upon the location of their transactions (the service center).

To reduce the paperwork and compliance burdens on service centers, which service mainly federally-insured credit unions, NCUA proposed to change this disclosure requirement to a disclosure of *non*-federally insured credit unions serviced at a service center. Twelve of the 17 relevant comments supported this approach. Five of the comments preferred the current requirement.

After further consideration, the Board has decided not to revise the service center posting requirement. The Board is very concerned about credit union member confusion about account insurance. The NCUSIF is backed by the full faith and credit of the United States. Private insurance is backed only by the assets of the insurance company. Since 1990, concerns with privately-provided primary, non-excess account insurance has led to elimination of private account insurers in Florida, Georgia, Massachusetts, Rhode Island, Tennessee, Texas, and Washington State. While NCUA is aware of the statutorily-mandated disclosures that nonfederally insured credit unions must give to their members, 12 U.S.C. 1831t, NCUA is concerned that some member confusion might still exist leading the member of a nonfederally insured credit union to believe that his or her deposits were federally insured by the NCUSIF. Therefore, the signage requirement will remain unchanged.

Private, non-federally insured credit union members may believe that their accounts are federally-insured and backed by the full faith and credit of the United States if they transact business where the blue, NCUA Insurance of Accounts sticker is used, such as at service center locations. NCUA's concern is heightened by the recent proliferation of the use of service center outlets. Outlets are existing federally-insured and non-federally insured credit union branches that are wired to handle simple deposit and withdrawal teller window transactions for any member of any other credit union participating in that service center company. Plans are currently underway to link various service center locations to facilitate a national service center business using existing credit union branches as outlets. Thus, privately-insured credit union members will soon be able to transact credit union business in federally-insured credit union branches, perhaps on a national basis. The Board is concerned over this situation and has directed staff to study the issue.

H. DERIVATION TABLE

Original provision	New provision	Comment
701.27(a)	712.1	Modified.
701.27(b)	712.6(a)	Modified.
701.27(c)	N/A	Removed.
701.27(d)(1)	712.2(a–c)	Modified.
701.27(d)(2)(i–ii)	712.3(a)	Significantly Changed
701.27(d)(3)	712.4(b)	Significantly Changed.
701.27(d)(4)	712.3(b)	Modified.
701.27(d)(5)(i–ii)	712.5(a–o)	Modified.
701.27(d)(5)(iii)	712.7	Modified.
701.27(d)(6)(i–iii)	712.8(a–c)	Modified.
701.27(d)(7)(i)	712.3(c)	Modified.
701.27(d)(7)(ii)(A–C)	712.3(d)(1–3)	Modified.
701.27(d)(8)(i–ii)(A–B)	712.9(a–b)(1–2)	Modified.
701.27(e)	712.3(e)	No change.
N/A	712.4(a)	Added.
N/A	712.6(b)	Added.

II. Regulatory Procedures

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare any analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (primarily those under $1 million in assets). The CUSO and service contract rule revisions reduce existing regulatory burdens. No commenters commented on Regulatory Flexibility Act issues. Therefore, the NCUA Board has determined and certifies that the final rule does not have a significant economic impact on a substantial number of small credit unions. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

B. Paperwork Reduction Act

The reporting requirements in Part 712 have been submitted to the Office of Management and Budget. A notice will be published in the **Federal Register** once approval is received from OMB. Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The control number will be displayed in the table at 12 CFR Part 795.

C. Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The final CUSO regulation applies only to FCUs. The NCUA Board has determined that the final rule does not constitute a ''significant regulatory action'' for purposes of the Executive Order. However, as in the past, NCUA will work with the state credit union supervisors to achieve shared goals involving viability, flexibility, parity, conformity and safety and soundness

concerning CUSOs with both FCU and state-chartered credit union participation.

D. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Public Law 104–121) provides generally for Congressional review of agency rules. The reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act, 5 U.S.C. 551.

OMB has determined that this final rule on Part 712 does not constitute a ''major'' rule as defined by the statute. A ''major'' rule is defined as being any final rule that the Administrator of the Office of Information and Regulatory Affairs of OMB finds has resulted in or is likely to result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States based enterprises to compete with foreign-based enterprises in domestic and export markets.

List of Subjects

12 CFR Part 701

Credit, Credit unions, Insurance, Reporting and recordkeeping requirements, Surety bonds.

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 712

Administrative practice and procedure, Credit, Credit unions, Investments, Reporting and recordkeeping requirements.

12 CFR Part 740

Advertising, Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements, Signs and symbols.

By the National Credit Union Administration Board on February 25, 1998.

Becky Baker,

Secretary of the Board.

For the reasons set forth in the preamble, 12 CFR chapter VII is amended as follows:

PART 701—ORGANIZATION AND OPERATION OF FEDERAL CREDIT UNIONS

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, 1789 and 1798. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1861 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

2. Section 701.26 is amended by removing paragraph (b) and removing the paragraph designation (a).

§ 701.27 [Removed]

3. Section 701.27 is removed.

§ 701.36 [Amended]

4. Section 701.36 is amended in paragraph (a)(4)(iv) by revising ''§ 701.27'' to read ''part 712.''

PART 704–CORPORATE CREDIT UNIONS

5. The authority citation for part 704 continues to read as follows:

Authority: 12 U.S.C. 1762, 1766(a), 1781 and 1789.

§ 704.11 [Amended]

6. Section 704.11 is amended in paragraph (e) by revising ''§ 701.27'' to read ''part 712.''

7. Part 712 is added to read as follows:

PART 712—CREDIT UNION SERVICE ORGANIZATIONS (CUSOs)

Sec.

Authority: 12 U.S.C. 1756, 1757(5)(D) and (7)(I), 1766, 1782, 1784, 1785, and 1786.

§ 712.1 What does this part cover?

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 title. This part does not apply to state-chartered credit unions or the subsidiaries of state-chartered credit unions that do not have FCU investments or loans.

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

(a) *Investments.* An FCU's total investments in CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. For purposes of paragraphs (a) and (b) of this section, ''paid-in and unimpaired capital and surplus'' means shares and undivided earnings. An FCU can only invest in a CUSO as an equityholder of a corporation, as a member of a limited liability company, or as a limited partner of a limited partnership.

(b) *Loans.* An FCU's total loans to CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. Loan authority is independent and separate from the 1% investment authority of subsection (a) of this section.

(c) *Parties.* An FCU may invest in, or loan to, a CUSO by itself, or with other credit unions, or with non-depository institution parties not otherwise prohibited by § 712.6 of this part.

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

(a) *Structure.* An FCU can invest in or loan to a CUSO only if the CUSO is structured as a corporation, limited liability company, or limited partnership. For purposes of this part, ''corporation'' means a legally incorporated corporation as established and maintained under relevant state law. For purposes of this part, ''limited partnership'' means a legally established limited partnership as established and maintained under relevant state law. For purposes of this part, ''limited liability company'' means a legally established limited liability company as established and maintained under relevant state law, provided that the FCU obtains written legal advice that the limited liability company is a recognized legal entity under the applicable laws of the state of formation and that the limited liability company is established in a manner that will limit potential exposure of the FCU to no more than the amount of funds invested in, or loaned to, the CUSO.

(b) *Customer base.* An FCU can invest in or loan to a CUSO only if the CUSO primarily serves credit unions, its membership, or the membership of credit unions contracting with the

CUSO. However, if in order for the CUSO to provide a permissible service it is necessary for the CUSO to own stock in a service provider not meeting the customer base requirement, then the CUSO can buy and own the minimal amount of service provider stock necessary to provide the service without violating the customer base requirement.

(c) *Federal credit union accounting.* An FCU must account for its investments in or loans to a CUSO in conformity with ''generally accepted accounting principles'' (GAAP).

(d) *CUSO accounting; audits and financial statements; NCUA access to information.* An FCU must obtain written agreements from a CUSO, prior to investing in or lending to the CUSO, that the CUSO will:

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

(2) Prepare quarterly financial statements and obtain an annual opinion audit, by a licensed Certified Public Accountant, on its financial statements in accordance with ''generally accepted auditing standards'' (GAAS); and

(3) Provide NCUA and 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 in carrying out its responsibilities under the Act.

(e) *Other laws.* A CUSO must comply with applicable Federal, state and local laws.

§ 712.4 What must an FCU and a CUSO do to maintain separate corporate identities?

(a) *Corporate separateness.* An FCU and a CUSO must be operated in a manner that demonstrates to the public the separate corporate existence of the FCU 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 FCU does not dominate the CUSO to the extent that the CUSO is treated as a department of the FCU; and

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

(b) *Legal opinion.* Prior to an FCU investing in a CUSO, the FCU must obtain written legal advice as to whether the CUSO is established in a manner that will limit potential exposure of the FCU to no more than the loss of funds invested in, or lent to, the CUSO. In addition, if a CUSO in which an FCU has an investment plans to change its structure under § 712.3(a), an FCU must also obtain prior, written legal advice that the CUSO will remain established in a manner that will limit potential exposure of the FCU 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 FCU or the CUSO.

§ 712.5 What activities and services are preapproved for CUSOs?

NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit any CUSO activities or services, or refuse to permit any CUSO activities or services. Otherwise, an FCU may invest in, loan to, and/or contract with only those CUSOs that are sufficiently bonded or insured for their specific operations and only provide one or more of the following activities and services related to the routine, daily operations of credit unions:

(a) *Checking and currency services:*

(1) Check cashing;

(2) Coin and currency services; and

(3) Money order, savings bonds, travelers checks, and purchase and sale of U.S. Mint commemorative coins services;

(b) *Clerical, professional and management services:*

(1) Accounting services;

(2) Courier services;

(3) Credit analysis;

(4) Facsimile transmissions and copying services;

(5) Internal audits for credit unions;

(6) Locator services;

(7) Management and personnel training and support;

(8) Marketing services;

(9) Research services; and

(10) Supervisory committee audits;

(c) *Consumer mortgage loan origination;*

(d) *Electronic transaction services:*

(1) Automated teller machine (ATM) services;

(2) Credit card and debit card services;

(3) Data processing;

(4) Electronic fund transfer (EFT) services;

(5) Electronic income tax filing;

(6) Payment item processing;

(7) Wire transfer services; and

(8) Cyber financial services;

(e) *Financial counseling services:*

(1) Developing and administering Individual Retirement Accounts (IRA), Keogh, deferred compensation, and other personnel benefit plans;

(2) Estate planning;

(3) Financial planning and counseling;

(4) Income tax preparation;

(5) Investment counseling; and

(6) Retirement counseling;

(f) *Fixed asset services:*

(1) Management, development, sale, or lease of fixed assets; and

(2) Sale, lease, or servicing of computer hardware or software;

(g) *Insurance brokerage or agency:*

(1) Agency for sale of insurance;

(2) Provision of vehicle warranty programs; and

(3) Provision of group purchasing programs;

(h) *Leasing:*

(1) Personal property; and

(2) Real estate leasing of excess CUSO property;

(i) *Loan support services:*

(1) Debt collection services;

(2) Loan processing, servicing, and sales; and

(3) Sale of repossessed collateral;

(j) *Record retention, security and disaster recovery services:*

(1) Alarm-monitoring and other security services;

(2) Disaster recovery services;

(3) Microfilm, microfiche, optical and electronic imaging, CD–ROM data storage and retrieval services;

(4) Provision of forms and supplies; and

(5) Record retention and storage;

(k) *Securities brokerage services;*

(l) *Shared credit union branch (service center) operations;*

(m) *Student loan origination;*

(n) *Travel agency services; and*

(o) *Trust and trust-related services:*

(1) Acting as administrator for prepaid legal service plans;

(2) Acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity; and

(3) Trust services.

§ 712.6 What activities and services are prohibited for CUSOs?

(a) *General.* CUSOs must not acquire control of, either directly or indirectly, another depository financial institution, nor invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility or

similar organization, corporation, or association.

(b) *Real estate brokerage CUSO.* An FCU may not invest in, or loan to, a CUSO engaged in real estate brokerage services after April 1, 1998, except as provided in § 712.9.

§ 712.7 What must an FCU do to add activities or services that are not preapproved?

In order for an FCU to invest in and/or loan to a CUSO that offers an unpreapproved activity or service, the FCU must first receive NCUA Board approval. The request for NCUA Board approval of an unpreapproved activity or service must include a full explanation and complete documentation of the activity or service and how that activity or service is associated with routine credit union operations. The request must be submitted jointly to your Regional Office and to the Secretary of the Board. The request will be treated as a petition to amend § 712.5 and NCUA will request public comment or otherwise act on the petition within 60 days after receipt.

§ 712.8 What transaction and compensation limits might apply to individuals related to both an FCU and a CUSO?

(a) *Officials and Senior Management Employees.* The officials, senior management employees, and their immediate family members of an FCU that has outstanding loans or investments in a CUSO must not receive any salary, commission, investment income, or other income or compensation from the CUSO either directly or indirectly, or from any person being served through the CUSO. This provision does not prohibit such FCU officials or senior management employees from assisting in the operation of a CUSO, provided the officials or senior management employees are not compensated by the CUSO. Further, the CUSO may reimburse the FCU for the services provided by such FCU officials and senior management employees only if the account receivable of the FCU due from the CUSO is paid in full at least every 120 days. For purposes of this paragraph (a), ''official'' means affiliated credit union directors or committee members. For purposes of this paragraph (a), ''senior management employee'' means affiliated credit union chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g. Assistant President, Vice President, or Assistant Treasurer/Manager) and the chief financial officer (Comptroller). For purposes of this paragraph (a), ''immediate family member'' means a spouse or other family members living in the same household.

(b) *Employees.* The prohibition contained in paragraph (a) of this section also applies to FCU employees not otherwise covered if the employees are directly involved in dealing with the CUSO unless the FCU's board of directors determines that the FCU employees' positions do not present a conflict of interest.

(c) *Others.* All transactions with business associates or family members of FCU officials, senior management employees, and their immediate family members, not specifically prohibited by paragraphs (a) and (b) of this section must be conducted at arm's length and in the interest of the FCU.

§ 712.9 When must an FCU comply with this part?

(a) *Investments.* An FCU's investments in CUSOs in existence prior to April 1, 1998, must conform with this part not later than April 1, 2001, unless the Board grants prior approval to continue such investment for a stated period.

(b) *Loans.* An FCU's loans to CUSOs in existence prior to April 1, 1998, must conform with this part not later than April 1, 2001, unless:

(1) The Board grants prior approval to continue the FCU's loan for a stated period; or

(2) Under the terms of its loan agreement, the FCU cannot require accelerated repayment without breaching the agreement.

[FR Doc. 98–5450 Filed 3–4–98; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 98–ACE–5]

Revocation and Establishment of Class D; and Revocation, Establishment and Modification of Class E Airspace Areas; Olathe, Johnson County Industrial Airport, KS

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Direct final rule; request for comments.

SUMMARY: This action revokes the Class D and Class E airspace areas designated ''Olathe, Johnson County Industrial Airport, KS,'' and establishes a Class D and a larger Class E airspace area in their place designated ''Olathe, New Century Aircenter, KS.'' The name of the Olathe, Johnson County Industrial Airport has been changed to Olathe, New Century Aircenter. In order to rename the Class D and Class E areas it is necessary to evoke the existing airspace designation, and to reestablish the airspace under the new designation. This action also increases the size of the Class E airspace area extending upward from 700 feet Above Ground Level (AGL). A revision to the Airport Reference Point (ARP) coordinates is included in this document. This additional controlled airspace is necessary to accommodate the criteria for diverse departures as specified in FAA Order 7400.2D.

DATES: *Effective date:* 0901 UTC, June 18, 1998.

COMMENT DATE: Comments for inclusion in the Rules Docket must be received on or before May 1, 1998.

ADDRESSES: Send comments regarding the rule in triplicate to: Manager, Airspace Branch, Air Traffic Division, ACE–520, Federal Aviation Administration, Docket Number 98–ACE–5, 601 East 12th Street, Kansas City, MO 64106.

The official docket may be examined in the Office of the Regional Counsel for the Central Region at the same address between 9:00 a.m. and 3:00 p.m., Monday through Friday, except Federal holidays.

An informal docket may also be examined during normal business hours in the Air Traffic Division at the same address listed above

FOR FURTHER INFORMATION CONTACT: Kathy Randolph, Air Traffic Division, Airspace Branch, ACE–520C, Federal Aviation Administration, 601 East 12th Street, Kansas City, MO 64106; telephone: (816) 426–3408.

SUPPLEMENTARY INFORMATION: This amendment to 14 CFR 71 revokes the Class D and Class E airspace at Olathe, Johnson County Industrial Airport, KS, and reestablishes Class D and Class E airspace at Olathe, New Century Aircenter, KS. The enlarged Class E airspace at Olathe, New Century Aircenter will comply with the criteria in FAA Order 7400.2D for diverse departures. The criteria in FAA Order 7400.2D for an aircraft to reach 1,200 feet AGL, is based on a standard climb gradient of 200 feet per mile, plus the distance from the ARP to the end of the outermost runway. Any fractional part of a mile is converted to the next higher tenth of a mile. The Class D and Class E areas also indicate the new ARP and name. The enlarged Class E airspace at