



NATIONAL CREDIT UNION ADMINISTRATION  
Washington, D.C. 20516

March 16, 1987

Office of General Counsel

Mr. Robert R. Pierce, President  
Credit Insurance Agency, Inc.  
P.O. Box 180  
Battle Creek, MI 49016

Dear Mr. Pierce:

This is in response to your recent letter concerning a possible conflict with you serving as a member of the board of directors of your Federal credit union ("FCU") and your insurance agency underwriting credit insurance for the FCU.

Part 721 of the NCUA Regulations (enclosed) provides the authority for FCU's to make insurance plans of third party vendors (such as your agency) available to FCU members. Section 721.2(c) of the regulation states in part as follows:

"No official or employee of a Federal credit union or any immediate family member of an official or employee may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this regulation."

Section 721.2(c) would prohibit you, as a director of the FCU, from selling your insurance product to the FCU or to its members through the FCU.

You also mention credit union service organizations ("CUSO's") in your letter. An FCU may offer insurance products to its membership through a CUSO (See Section 701.27(d)(5)(ii) of the NCUA Rules and Regulations, 12 C.F.R. §701.27(d)(5)(ii).) A copy of Section 701.27 is enclosed. The CUSO regulation also contains a provision on conflict of interest similar to Section 721.2 discussed above. Section 701.27(d)(6) states in part as follows:

"Individuals who serve as officials of, or are employed by, an affiliated FCU . . . and immediate family members of such individuals, may not receive any salary, commission, investment income, or other income or compensation from a CUSO, directly or indirectly, or from any person being served through the CUSO."

Mr. Robert R. Pierce

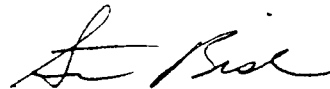
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The CUSO regulation prohibits you, as a director of the FCU, from earning any income through insurance sales to the FCU or its membership.

In order to maintain your relationship as provider of credit insurance for your FCU, either with or without a CUSO, you will not be able to serve as a director of your FCU.

We appreciate your concern with this issue and hope that we have been of assistance.

Sincerely,



STEVEN R. BISKER  
Assistant General Counsel

HMU:sg

Enclosures

### §721.1 Authority

A federal credit union may make insurance and group purchasing plans involving outside vendors available to the membership (including endorsement), and may perform administrative functions on behalf of the vendors.

# Part 721

## Federal Credit Union Insurance and Group Purchasing Activities

### §721.2 Reimbursement.

(a) For purposes of paragraph (b) of this section, the following definitions shall apply:

(1) "Dollar amount" shall mean \$4 per single payment policy, \$6 per combination policy, or \$4 per annum for any other type of policy; and

(2) "Cost amount" shall mean the total of the direct and indirect costs to the Federal credit union of any administrative functions performed on behalf of the vendor. The Federal credit union must be able to justify this amount using standard accounting procedures.

(b) A Federal credit union may be reimbursed or compensated by a vendor for activities performed under § 721.1 as follows:

(1) Except as otherwise provided by applicable state insurance law, reimbursement or compensation is not limited with respect to insurance sales

by the credit union or its employees which are directly related to an extension of credit by the credit union or directly related to the opening or maintenance of a share, share draft or share certificate account at the credit union;

(2) For insurance sales other than those described in paragraph (b)(1), a Federal credit union may receive an amount not exceeding the greater of the dollar amount or the cost amount;

(3) For group purchasing plans other than insurance, a Federal credit union may receive an amount not exceeding the cost amount.

(c) No official or employee of a Federal credit union or any immediate family member of an official or employee may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this regulation. For purposes of this section, "immediate family member" means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or spouse of any such individual.

(iii) A written agreement covering the pledging arrangement is retained in the office of the credit union that pledges the eligible obligations.

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

(e) Servicing.

A Federal credit union may agree to service any eligible obligation it purchases or sells in whole or in part.

(f) 10 Percent Limitation.

The total indebtedness owing to any Federal credit union by any person, inclusive of retained and reacquired interests, shall not exceed 10 percent of its unimpaired capital and surplus.

#### §701.24 Refund of interest.

(a) The board of directors of a Federal credit union may authorize an interest refund to members who paid interest to the credit union during any dividend period and who are members of record at the close of business on the last day of such dividend period.

(b) The amount of interest refund to each member shall be determined as a percentage of the interest paid by the member. Such percentage may vary according to classifications of loans established pursuant to 12 C.F.R. 701.21-1(d).\*

(c) Based upon a determination that such loans have not made a significant contribution to the earnings that make the refund possible, the board of directors may exclude from an interest refund (i) any classification of loans determined in accordance with paragraph (b) of this section, and (ii) all loans delinquent at least two months, or all loans delinquent for such greater period as is determined by the board.

(d) The board of directors minutes shall document the reasons for any decision to vary interest refund rates or exclude certain loans from a refund.

(e) The board of directors may authorize an interest refund for a dividend period only during such time as it may declare a dividend. However, if in a given calendar year a credit union has dividend periods more frequent than annual and an interest refund was not authorized for one or more dividend periods, the board, during the time permitted for the declaration of the current dividend, may authorize an interest refund for the current dividend period and for any one or more of the omitted dividend periods.

(f) The board of directors shall not authorize an interest refund for any dividend period [Should read 701.21.]

unless dividends have been declared and paid on share accounts.

(g) An interest refund shall be recorded on the books of the credit union as a reduction of interest income.

#### §701.25 Deleted August 1977.

#### §701.26 Credit Union Service Contracts.

(a) A Federal credit union may act as a representative of and enter into a contractual agreement with one or more credit unions or other organizations for the purpose of sharing, utilizing, renting, leasing, purchasing, selling, and/or joint ownership of fixed assets or engaging in activities and/or services which relate to the daily operations of credit unions. Agreements must be in writing, and shall advise all parties subject to the agreement that the goods and services provided shall be subject to examination by the NCUA Board to the extent permitted by law.

(b) Where any agreement calls for, or requires, the payment in advance of the actual or estimated charges for more than 3 months such payment shall be deemed an investment in a credit union service organization and subject to the limitations delineated in Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. Section 1757(5)(I) and 1757(5)(D)).

#### §701.27 Investments in and Loans to Credit Union Service Organizations.

(a) *Scope.* Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. 1757(7)(I) and 1757(5)(D)) authorize Federal credit unions to invest in and make loans to credit union service organizations. This regulation implements those sections by addressing various issues, including monetary limits on loans and investments, the structure of credit union service organizations, their customer base, and the range of services and activities that they may provide. The regulation also establishes prudential standards for Federal credit union involvement with credit union service organizations, through provisions concerning conflicts of interest, accounting practices, and NCUA access to books and records. The regulation applies only in cases where one or more Federal credit unions have invested in or made loans to an organization pursuant to Section 107(7)(I) or 107(5)(D). The regulation does not regulate credit union service organizations directly but rather

establishes conditions of Federal credit union investments in and loans to such organizations.

(b) *Limits imposed by the Federal Credit Union Act.* (1) Section 107(7)(I) of the Act:

(i) Authorizes a Federal credit union to invest in shares, stock or obligations of credit union service organizations in amounts not exceeding, in the aggregate, 1% of the credit union's paid-in and unimpaired capital and surplus;

(ii) Limits credit union service organizations to providing services associated with the routine operations of credit unions; and

(iii) Prohibits a Federal credit union from utilizing this authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility, or other similar organization.

(2) Section 107(5)(D) of the Act:

(i) Authorizes a Federal credit union to make loans to credit union service organizations in amounts not exceeding, in the aggregate, 1% of its paid-in and unimpaired capital and surplus (this is independent of the 1% investment limit pursuant to Section 107(7)(I));

(ii) Requires that credit union service organizations exist primarily to meet the needs of their member credit unions; and

(iii) Limits credit union service organizations to business relating to the daily operations of the credit unions they serve.

(c) *Definitions.*—(1) *Affiliated credit unions* means those credit unions that have either invested in or made loans to a credit union service organization.

(2) *Official* means any director or committee member.

(3) *Immediate family member* means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or the spouse of any such individual.

(4) *Paid-in and unimpaired capital and surplus* means shares and undivided earnings.

(d) *Regulatory provisions.*—(1) *Limits on funding.* A Federal credit union by itself, with other credit unions and/or with non-credit union parties, may invest in and/or loan to a credit union service organization. A Federal credit union's investments in credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. A Federal credit union's loans to credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last

calendar year-end financial report.

(2) *Structure.* A Federal credit union may invest in or loan to a credit union service organization only if the organization is structured as either a corporation or limited partnership.

(i) *Corporation.* A credit union service organization chartered as a corporation must be adequately capitalized and operated as a separate entity. A Federal credit union investing in or making loans to such a corporation must take those steps necessary to ensure that it will not be held liable for obligations of the corporation.

(ii) *Limited partnership.* A Federal credit union may participate only as a limited partner in a credit union service organization structured as a limited partnership. As a limited partner, the Federal credit union must not engage in those activities (e.g., control, management, decision-making), which, under state law, would cause the credit union to lose its status as limited partner, and correspondingly its limited liability, and be treated as a general partner.

(3) *Legal opinion.* A Federal credit union making an investment in or loan to a credit union service organization must obtain written legal advice as to whether the credit union service organization is established in a manner that will limit the credit union's potential exposure to no more than the loss of funds invested in or lent to the credit union service organization.

(4) *Customer base.* A Federal credit union may invest in or loan to a credit union service organization only if the organization primarily serves credit unions and/or the membership of affiliated credit unions (as defined in paragraph (c)(1) of this Section).

(5) *Permissible services and activities.* A Federal credit union may invest in and/or loan to those credit union service organizations that provide only one or more of the following services and activities:

(i) *Operational services.* Credit card and debit card services; check cashing and wire transfers; internal audits for credit unions; ATM services; EFT services; accounting services; data processing; shared credit union branch (service center) operations; sale of repossessed collateral; management, development, sale or lease of fixed assets; sale, lease or servicing of computer hardware or software; management and personnel training and support; payment item processing; locator services; marketing services; research services; record retention and storage; microfilm and microfiche services; alarm-monitoring and other security services; debt collection services; credit analysis; consumer mortgage loan origination;

loan processing, servicing and sales; coin and currency services; provision of forms and supplies.

(ii) *Financial services.* Financial planning and counseling; retirement counseling; investment counseling; securities brokerage services; estate planning; income tax preparation; acting as administrator for prepaid legal service plans; developing and administering IRA, Keogh, deferred compensation, and other personnel benefit plans; trust services; acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity; real estate brokerage services; travel agency services; agent for sale of insurance; personal property leasing; and provision of vehicle warranty programs.

(iii) *NCUA approval of other services.* Any service or activity which is not authorized in paragraph (d)(5)(i) or (ii) of this Section must receive NCUA Board approval before a Federal credit union may invest in and/or loan to the credit union service organization that offers the service or activity. Any request for NCUA Board approval of a new service or activity should include a full explanation and complete documentation of the service or activity and how that service or activity is associated with routine credit union operations. The request should be submitted to the appropriate NCUA Regional Office. The request will be treated as a petition to amend paragraph (d)(5)(i) or (ii) of this Section and NCUA will request public comment or otherwise act on the petition within 60 days after receipt.

(6) *Conflict of interest.* Individuals who serve as officials of, or are employed by, an affiliated Federal credit union (as defined in (c)(1)), and immediate family members of such individuals, may not receive any salary, commission, investment income, or other income or compensation from a credit union service organization either directly or indirectly, or from any person being served through the credit union service organization. This provision does not prohibit an official or employee of a Federal credit union from assisting in the operation of a credit union service organization, provided the individual is not compensated by the credit union service organization. Further, the credit union service organization may reimburse the Federal credit union for the services provided by the individual.

(7) *Accounting procedures; access to information.*—(i) *Federal credit union accounting.* A Federal credit union must follow generally accepted accounting principles (GAAP) in its involvement with credit union service organizations.

(ii) *Credit union service organization accounting; audits and financial statements; NCUA access*

*to books and records.* An affiliated Federal credit union must obtain written agreements from a credit union service organization, prior to investing in or lending to the organization, that the organization will:

(A) Follow GAAP,

(B) Render financial statements (balance sheet and income statement) at least quarterly and obtain a Certified Public Accountant audit annually and provide copies of such to the affiliated Federal credit union, and

(C) Provide the NCUA Board, or its representatives, with complete access to any books and records of the credit union service organization, as deemed necessary by the Board in carrying out its responsibilities under the Federal Credit Union Act.

(8) *Preexisting credit union service organizations.*

(i) Any Federal credit union investments in existence prior to the effective date of this regulation, May 27, 1986, must conform with this regulation not later than May 27, 1987, unless the NCUA Board grants its prior approval to continue such investment for a stated period.

(ii) Any Federal credit union loans in existence prior to the effective date of this regulation must conform with this regulation not later than May 27, 1987, unless:

(A) The NCUA Board grants its prior approval to continue the loan for a stated period, or

(B) Under the terms of its loan agreement the Federal credit union cannot require accelerated repayment without breaching the agreement.

(e) *Others laws.* A credit union service organization must comply with applicable Federal, state and local laws.

### §701.28 Deleted July 1982

### §701.29 Deleted June 1979.

### §701.30 Safe deposit box service.

A Federal credit union may lease safe deposit boxes to its members.

### §701.31 Nondiscrimination requirements.

(a) *Definitions:* As used in this part, the term:

(1) 'application' carries the meaning of that term as defined in 12 C.F.R. 202.2(f) (Regulation B), which is as follows: "An oral or written request for an extension of credit that is made in accordance with procedures established by a