



**America's
Credit Unions**



January 19, 2024

The Honorable Todd M. Harper, Chairman
The Honorable Kyle S. Hauptman, Vice Chairman
The Honorable Tanya F. Otsuka, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

RE: Expanding Credit Union Innovation Opportunities and Investment in Fintech

Dear Chairman Harper, Vice Chairman Hauptman, and Board Member Otsuka:

On behalf of America's Credit Unions and the National Association of Credit Union Service Organizations (NACUSO), we are writing to request your support in enhancing credit union opportunities to engage with and invest in innovative technology solutions and fintech companies. America's Credit Unions is the voice of consumers' best option for financial services: credit unions. We advocate for policies that allow the industry to effectively meet the needs of their nearly 140 million members nationwide. NACUSO, established in 1985, is dedicated to fostering innovation, collaboration, and sustainability within the credit union industry. Continuing to evolve, NACUSO now educates credit unions on the advantages of industry collaboration, facilitates partnerships for innovative solutions, supports the formation of multi-owned CUSOs for economies of scale and expertise, and advocates for collaboration-centric regulatory and legislative measures to benefit CUSOs and their credit union owners.

America's Credit Unions and NACUSO appreciate the Board's previous efforts to expand financial innovation for credit unions and believe now is the time to further enhance opportunities to promote the strategic use of and engagement with technology through investments in fintech companies. The National Credit Union Administration (NCUA) should revise its investment regulations, Part 703, to allow for additional investment in fintech companies outside of the existing authorities and limitations for investments through credit union service organizations (CUSOs) under Part 712.

Several years ago, both the National Association of Federally-Insured Credit Unions (NAFCU) and the Credit Union National Association (CUNA) partnered with NACUSO¹ to advocate for this regulatory modernization, and now we are renewing that request. We are eager to find even more ways for regulations to be revised to fit the realities of an increasingly technology-driven

¹ See NACUSO, *Enabling Collaborative Fintech in the Credit Union Industry* (Feb. 23, 2021).

landscape where consumers demand simple and convenient solutions to their banking needs. We are also interested in highlighting opportunities for credit unions to work with the agency, specifically its Office of Financial Technology and Access, to learn about potential partners and experiment with regulatory flexibilities or pilot programs that can help facilitate innovation and allow credit unions to better serve their members and communities.

America's Credit Unions and NACUSO are eager to work with you to propel the credit union movement forward, ensuring communities have access to the highest quality financial products and services available in the marketplace, with the type of speed, convenience, and features offered through technology solutions.

This Change is in Line with the Law and Current NCUA Regulations

NCUA regulations Part 703 outline several permissible investment activities² and permissible investments for federal credit unions.³ These investments cover a variety of investment instruments, ranging from those issued by institutions described in section 107(8) of the Federal Credit Union (FCU) Act⁴ to commercial mortgage related securities.⁵ Section 107(7) of the FCU Act permits FCUs to invest their funds in:

[T]he shares, stocks, or obligations of any other organization, providing *services which are associated with the routine operations of credit unions*, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Board: Provided, however, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this chapter...(emphasis added).⁶

The FCU Act already limits the types of investments in shares, stocks, or obligations of any organization to those that provide permissible services related to the routine operations of credit unions. A variety of fintech services (e.g., digital accounts, automated underwriting, artificial intelligence and machine learning in data processing and inputs) could fall squarely within this category of "routine operations" and should therefore be clearly authorized by the Board as a permissible investment. The NCUA should clarify this specific interpretation of FCU Act section 107(7) in Part 703 by creating a new section 703.21. It is critical to codify that this investment authority goes beyond the current permissible investments available through CUSOs.

The CUSO regulations permit investments in CUSOs that provide financial technology, but the CUSO must primarily serve credit unions,⁷ which only offers a limited addressable market in which to operate, restricting the CUSO's ability to attain scale and meaningful growth. As a result, many fintech companies may be uninterested in becoming a CUSO in order to serve the

² See § 703.13.

³ See § 703.14.

⁴ See § 703.14(f).

⁵ See § 703.14(j).

⁶ 12 U.S.C. § 1757(7).

⁷ See § 712.1(d).

credit union industry. Credit union investments in CUSOs are also limited to an aggregate 1 percent of paid-in and unimpaired capital and surplus as of the last calendar year-end financial report.⁸ Permissible investments in fintech companies should contain their own 1 percent limitation, in addition to permissible CUSO investments, for each individual credit union investment because limiting all investments into fintech services to only those offered through CUSOs severely restricts a credit union's options and ability to engage with companies that have the scale, resources, and ability to impact the markets for these services. Investments into fintech companies should be a distinct category of permissible investments in Part 703 as they are not subject to the CUSO limitations in section 712.1(d) of "primarily providing products or services to credit unions or credit union members" so that credit unions are able to work with companies that offer innovative solutions to meet the needs of their members and to share in the growth of that company, further benefitting members.

States are Adopting More Innovation-Focused Rules

Several states have considered and adopted changes to their rules to permit greater investment in companies that serve credit unions and their members aside from CUSOs. For example, in 2022, Washington passed into law a bill⁹ that amended its state code so that a credit union may invest funds in a variety of ways so long as the investments are deemed prudent by the credit union's board of directors or:

To aid in achieving its business or operational objectives, a credit union may invest in equity interests in corporations or other limited liability entities, *whether or not the principal business of such other corporation or entity is related to the credit union's business*. An "equity interest" is an interest such as stock in a corporation or membership in a limited liability company or a limited partnership interest in which the credit union's liability is limited to the amount of its investment and the credit union does not take on general liability (emphasis added).¹⁰

While this investment authority may seem very broad, it is subject to a number of limitations, including an aggregate investment amount not to exceed 2.5 percent of the net worth of the credit union until January 1, 2025, and then not to exceed 5 percent of net worth thereafter.¹¹ Additionally, such investments are only to be undertaken with "the prior authorization of the director and subject to such requirements, restrictions, or other conditions as the director may adopt by rule, order, directive, standard, policy, memorandum, or other written communication with regard to the activity."¹² Moreover, in approving or denying a proposed activity, the Washington director of financial institutions shall consider the financial and management strength of the credit union and the relationship of the activity to the credit union's operations.

⁸ See § 712.2(a).

⁹ HB 1165 – 2021-22.

¹⁰ Revised Code of Washington, § 31.12.436, Investment of funds—When investment later becomes impermissible, <https://app.leg.wa.gov/RCW/default.aspx?cite=31.12.436>.

¹¹ *Id.* at 31.12.436(2)(d), (e).

¹² *Id.* at 31.12.436(e).

Also in 2022, Illinois adopted a bill¹³ amending the Illinois Credit Union Act¹⁴ to permit additional investments for credit unions outside of those already permitted investments in CUSOs.¹⁵ More specifically, credit unions may invest funds not being used for loans to members in “shares, stocks, or member units of financial technology companies in the total amount not exceeding 2.5% of the net worth of the credit union...” so long as the credit union remains well capitalized, the credit union and the fintech are separate corporate entities, and the credit union has a CAMELS 1 or CAMELS 2 rating.¹⁶ For those credit unions with a CAMELS 1 rating, at the time of investment and all during the term of the investment, the investment limit is increased to 5 percent of the net worth of the credit union.¹⁷ Additional limitations and requirements also apply, including, for example, obtaining a written legal opinion as to whether the fintech is established in a manner that limits exposure to the credit union to no more than the amount invested and that the credit union must enter into a written investment agreement with the fintech before investing agreeing that the fintech will share certain financial information with the Illinois Department of Financial and Professional Regulation, Division of Financial Institutions and terms governing the termination of the contractual relationship with the credit union.¹⁸

The investment authorities provided by these new state laws demonstrate that credit unions need access to fintech investment options to further diversify their portfolios, further grow their institutions, and enhance technology solutions and services to members. All of these efforts benefit credit union members and are done with the primary purpose of expanding access and convenience for members. To keep pace with state credit union charters, further empower credit unions to compete with larger institutions and fintechs, and to counteract ongoing consolidation trends, the NCUA should amend its regulations to explicitly permit fintech investments.

Common-Sense Limitations to Promote Safety and Soundness

Expanding regulatory investment authorities may invoke concern regarding the safety and soundness of the investing institutions and the prudent use of credit union member funds. Most of the permissible investment options outlined in section 703.14 contain certain conditions, including limits on the percentage of assets invested,¹⁹ CAMELS rating requirements,²⁰ and documentation and credit analysis requirements.²¹ These regulatory limitations are important for providing the NCUA examiners with metrics upon which to evaluate credit union activities to determine safety and soundness. The state laws permitting credit unions to invest in fintech companies also provide several limitations and requirements to engage in that activity. Accordingly, several regulatory safeguards could be adopted to reasonably limit the extent of

¹³ Illinois HB 4462.

¹⁴ 205 ILCS 305, § 59(a)(15).

¹⁵ See Ill. Admin. Code tit. 38 § 190.5.

¹⁶ 205 ILCS 305, § 59(a)(15)(A)(i)-(iii).

¹⁷ *Id.* at § 59(a)(15)(B).

¹⁸ *Id.* at § 59(a)(15)(C), (D).

¹⁹ See § 701.14(b).

²⁰ See § 701.14(i).

²¹ See § 701.14(j)(1).

investment each credit union is able to make in fintechs in order to protect the safety and soundness of those institutions and the National Credit Union Share Insurance Fund. This permissible investment authority should not, however, be overly restrictive so as to stifle meaningful engagement with new fintechs and technologies.

For example, consistent with the FCU Act, the NCUA Board may adopt language capping the aggregate of all investments in entities by a single credit union under this new authority to not exceed 1 percent of a credit union's paid-in and unimpaired surplus and capital, as of its last calendar year-end financial report, at the time of investment. This investment limitation would mirror the spirit of the limitations in section 703 and align with the limits prescribed in section 712.2 for investments in CUSOs. The NCUA Board should clarify that an entity must be structured as a corporation, limited liability company, or limited partnership under state law and, at the time of investment, not be a publicly traded entity. The Board may also wish to incorporate the following provisions:

- Adequate policies and procedures for managing operational and financial risks related to such investments;
- Investments must be made in entities that are a logical outgrowth of a recognized credit union activity;
- Potential loss exposure must be limited to the amount of the investment and the credit union must not be exposed to open-ended liability; and
- Credit unions with a composite CAMELS rating less than 2 must submit an application to the NCUA and receive prior approval before making any such investments.

Protections may also include due diligence requirements such as obtaining a written legal opinion that the fintech is organized in a manner that the credit union will not be held liable for the obligations of the entity. Additionally, the Board may wish to explicitly outline provisions regarding conflicts of interest and prohibitions on self-dealing as well as require that the credit union enter into a written agreement with the fintech prior to making an investment to further clarify expectations for the investment agreement. These limits would control the risk exposure of credit unions that engage in such investments and ensure that the investment is in the best interest of the credit unions' members.

Reasonable investment limitations also include, similar to the language in the CUSO regulations,²² permitting continued investment if the 1 percent limitation is reached or exceeded due to the profitability of the entity under Generally Accepted Accounting Principles (GAAP) through valuation of the investment using the equity method without an additional cash outlay by the credit union. In this instance, the NCUA should not require divestiture and the credit union should be permitted to continue to invest up to the regulatory limit without regard to the increase in the GAAP valuation due to the entity's profitability. Similarly, divestiture should not be required if, down the line, an entity becomes a publicly traded entity, so long as the credit union had no knowledge of the entity's plans to do so.

²² § 712.2(e).

To facilitate investment in fintechs by smaller credit unions, in new section 703.21, the NCUA should also explicitly permit investments into a registered investment company or collective investment fund or pool. To limit exposure and protect participating credit unions, the prospectus of the company or fund should restrict its investment portfolio to investments that are permissible under the proposed regulation governing fintech investments. Allowing credit unions to pool their investments into a fund aligns with the cooperative spirit of the credit union mission and opens up doors for smaller credit unions to participate in these investments and reap the benefits of partnering with fintech companies.

Conclusion

Thank you for your consideration of this important regulatory change to promote innovative solutions and encourage credit unions to make strategic investments to benefit their institutions and their members. We would be happy to discuss this recommendation with you in further detail and welcome the opportunity to meet with you and your staff regarding this topic. If you have any questions, please do not hesitate to contact us at apetros@americascreditunions.org or blauer@cusolaw.com.

Sincerely,



Ann C. Petros
Vice President of Regulatory Affairs
America's Credit Unions



Brian Lauer
General Counsel
NACUSO