STATE OF MICHIGAN
DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS
OFFICE OF FINANCIAL AND INSURANCE REGULATION

Before the Commissioner of Financial and Insurance Regulation

In the matter of venture capital and small business equity investment services as an allowable service provided by credit union service organizations to Michigan credit unions or their members.

Order No. 12-046-M

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Issued and entered
this 17th day of August 2012
by R. Kevin Clinton
Commissioner

ORDER AUTHORIZING CREDIT UNION SERVICE ORGANIZATIONS TO PROVIDE ADDITIONAL PRODUCTS AND SERVICES TO STATE CHARTERED CREDIT UNIONS AND THEIR MEMBERS

I
BACKGROUND

On February 9, 2012, Wanigas Credit Union (WCU), a state-chartered credit union, requested the Commissioner exercise his authority under Section 407(2)(q) of the Michigan Credit Union Act (MCUA), to:

> Add small business equity investments as an additional permitted service for credit union service organizations (CUSOs) to provide to Michigan credit unions and their members.

While Section 407(2)(q) does not outline factors for Commissioner consideration for requests for new CUSO services or products, Section 208(2) of the MCUA does outline specific criteria to be considered in evaluating requests for additional powers made by Michigan chartered credit unions. These factors were utilized by OFIR in its review of the appropriateness of this additional service.

II
ISSUES

The principal issues are:

1. Whether the Commissioner is authorized under Section 407(2)(q) of the MCUA to grant additional service powers to CUSOs?

2. Taking into consideration the factors listed in Section 208(2) of the MCUA, are the additional services to be offered by CUSOs warranted?

III
ANALYSIS

Authority for granting additional powers

Section 401(2)(gg) of the MCUA provides the authority for Michigan credit unions to organize, invest in, or loan money to 1 or more CUSOs that engage primarily in providing 1 or more of a list of services provided in sections 407(2)(a) through (p). The services provided in (a) through (p) do not include small business equity or venture capital fund investment services. Under Section 407(2)(q) of the MCUA, the Commissioner may authorize CUSOs to provide additional products and services to Michigan credit unions and their members:

> (2) Subject to Section (3), a domestic credit union may organize, invest in, or loan money to 1 or more credit union service organizations that engage primarily in providing 1 or more of the following products or services to credit unions or their members:
>
> * * *
>
> (q) If approved by the commissioner, any other product or service.
>
> MCL 490.407(2)(q).

Factors considered

While not directly applicable to a request for additional services for a CUSO made pursuant to Section 407(2)(q), Section 208(2) of the MCUA specifies factors the Commissioner shall consider in making a determination as to a request for additional powers made by a state-chartered credit union:

> In acting under subsection (1), the commissioner shall consider the ability of the domestic credit unions to exercise the additional power in a safe and sound manner, the authority of the domestic credit unions under state or federal law or regulation, the powers of other competing entities providing

> financial services, and any specific limitations on domestic credit union powers contained in this act or in any rules or other law of this state.

These Section 208(2) factors are instructive and form the basis for the analysis of the request that is the subject of this order.

Safety and soundness

The proposed additional service would allow state-chartered credit union (SCU) investment in CUSOs that provide investment administration and other services related to small business equity or venture capital funding. The existing investment limitations and regulatory requirements found in sections 401(2)(gg) and 407 of the MCUA would continue to apply. Aggregate cash outlay to all CUSOs, including loans and equity investment, would remain limited to 6% of total assets of an SCU, without prior Commissioner approval, and at no point could exceed 12% of total assets. Additional limitations imposed would include: (1) an investment could not exceed 10% of SCU net worth in equity investment-related CUSOs, (2) concentration limitations of 20% of net worth at the CUSO level, and (3) an officer or director of a state-chartered credit union with an ownership interest or an investment in a CUSO shall not hold an equity position in any small business financed by that CUSO under this additional investment authority. Additional requirements included in this order will ensure appropriate regulatory and credit union risk management oversight.

Authority of state-chartered credit unions

Section 401(2)(gg) authorizes SCUs to invest in CUSOs that provide products and services to credit unions or their members. Section 407(2) provides a specific list of products and services authorized and Section 407(2)(q) provides the Commissioner the authority to approve additional products and services under this category.

The MCUA does not specifically authorize SCUs to offer small business equity and venture capital fund management and investment services to its members.

Competition

Authorizing domestic credit unions to invest in CUSOs providing small business equity and venture capital fund management and investment services will better enable SCUs to compete with non-credit union depository institutions.

SCUs compete with domestically chartered non-credit union depositories, and those competitors have the authority to directly enter into equity fund investments including Michigan Savings Banks under MCL 487.3405, and Michigan Banks under MCL 487.14305. While federal credit unions do not have this authority, credit unions chartered in other states do have the power to make these types of investments directly. An example of such authority is provided to Iowa chartered credit unions under ICL 533.304.

Specific limitations

There is no specific provision in the MCUA establishing any limitation on small business equity or venture capital fund investments. Implementation of this additional authority includes specific application of existing aggregate credit risk exposure limitations found within the MCUA, CUSO investment limitations and equity fund investment limitations on this activity found within the Michigan Bank Act and Savings Bank Act.

IV
FINDINGS OF FACT

Based upon the foregoing considerations, it is found that:

1. Small business equity and venture capital fund investment administration and services provided by CUSOs are appropriate and necessary in order for domestic credit unions to compete with other providers of financial services in this state.

2. CUSOs have the ability to offer the additional services in a safe and sound manner and state-chartered credit unions are subject to limitations and controls sufficient to ensure that any investment in CUSOs offering such additional services is exercised in a safe and sound manner.

V
CONCLUSIONS OF LAW

Based upon a review of applicable laws, it is concluded that:

1. Pursuant to Section 407(2)(q) of the MCUA, the Commissioner may authorize additional products and services provided by CUSOs to credit unions or their members.

2. Pursuant to Section 208(2) of the MCUA, it is necessary and proper for CUSOs to offer small business equity and venture capital investment administration and related services to its member credit unions and their respective members.

VI
ORDER

Therefore, it is ORDERED that services authorized for credit union service organizations under Section 407(2) of the MCUA shall include the following:

1. Investment administration and other services related to small business equity interests or venture capital fund investments under the following conditions:

   A. The target small business for a specific equity investment: (i) is a member of at least one of the credit unions with an ownership or investment interest in the credit union service organization providing the investment services, (ii) has its principal office in Michigan and (iii) has either more than one-half of its assets within this state or more than one-half of its employees employed within the state.

   B. Any venture capital fund established or funded by the CUSO agrees to provide an amount equal to at least fifty-one percent of its available funds to member small businesses having their principal offices within this state and having either more than one-half of their assets within this state or more than one-half of their employees employed within this state.

   C. A state-chartered credit union's aggregate investment in a CUSO offering small business equity and venture capital investment services shall not exceed 10% of the credit union's net worth.

   D. An officer or director of a state-chartered credit union with an ownership interest or an investment in a CUSO shall not hold an equity position in any small business financed by that CUSO under this additional investment authority.

   E. Aggregate state-chartered credit union risk exposure through all funding sources, loans or investments, to any entity or group of related entities does not exceed 25% of net worth.

2. The investing state-chartered credit union must:

   A. Fulfill all provisions of Sections 401(2)(gg) and 407(3) through 407(7) of the MCUA.

   B. Require periodic reporting monitoring compliance with the criteria established above for each small business equity interest or venture capital fund investment.

   C. Ensure accurate reporting of the CUSO within NCUA's 5300 reporting requirements.

D. Ensure the credit union service organization has enacted and complies with policy guidelines for obligations outstanding, including at a minimum:

i. Limits on the CUSO's exposure to no more than fifty percent of its total capital and surplus in any obligor or group of interrelated obligors.

ii. Acceptable types of entities into which equity investment may be funded.

iii. Acceptable business activities of entities into which investments may be funded.

iv. Acceptable geographic area in which an entity's principal place of business must be located.

v. Acceptable concentration risk guidelines, relative to net worth, that may be invested by: (1) industry, (2) geographic regions, (3) collateral and (4) any other material exposure factor.

vi. Required qualifications and experience of personnel involved in making and administering equity investments.

vii. Required origination and ongoing periodic underwriting analysis, including specific due diligence standards relating to periodic financial statements, credit reports, tax data, environmental impact assessments, industry average comparisons and other data that may be necessary to analyze the entity's history and experience.

viii. Required periodic market value analysis of all equity positions held.

3. For the purpose of this authority, the following definitions apply:

A. Equity Interests means limited partnership interests and other equity investments in which liability is limited to the amount of the investment, but does not mean general partnership interests or other interests involving general liability. Equity interests may include subordinated or convertible debt.

B. Small business means a corporation, partnership, limited liability company, proprietorship, or other entity formed under the laws of the United States, or a state, district, or territory of the United States, that meets the appropriate United States small business administration definition of small business and that is principally engaged in the development of exploitation of inventions, technological improvements, new processes, or other products not previously generally available in this state or other investments which provide an economic benefit to this state.

C. Venture capital fund means a limited liability entity formed under the laws of the United States, or a state, district, or territory of the United States, whose principal business is or will be the making of investments in and the provision of significant managerial assistance to businesses that meet the United States small business administration definition of small business.

R. Kevin Clinton
Commissioner