

**STATE OF MICHIGAN
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES**

Bulletin 2021-40-CU

In the matter of:

**CUSO Investment Compliance and
Safety and Soundness Considerations**

**Issued and entered
this 12th day of November 2021
by Anita G. Fox
Director**

This Bulletin supersedes Bulletin 2005-12-CU, issued on March 10, 2005, which is hereby rescinded.

The purpose of this bulletin is to provide guidance for credit unions investing in or lending to credit union service organizations (CUSOs), and to describe the basic due diligence and documentation that are expected for a credit union to demonstrate statutory permissibility of their CUSO investments/loans and evidence of satisfactory safety and soundness. While not all-encompassing, this bulletin is intended to aid credit unions in being able to demonstrate compliance.

Compliance

Under MCL 490.102(l), a “credit union service organization” means a corporation or other legal entity that is engaged primarily in providing 1 or more of the products or services described in section 407 to credit unions or their members, that a domestic credit union may organize, invest in, or lend to under section 401(2)(gg), and that may or may not be controlled by 1 or more credit unions.”

To be considered a CUSO for the purposes of the Michigan Credit Union Act, the phrase “engaged primarily in” (providing one or more products or services described in section 407) must be evaluated by any investing credit union. In evaluating an entity’s qualification as a CUSO, DIFS will consider the following factors:

- The allocation of gross income derived from various components (e.g., allocation of activity related to members vs non-members and/or credit unions vs non-credit unions);
- The allocation of expenses related to various components;
- Time, space and employees allocated to various components; and
- Other factors relevant to the particular circumstances.

Note that no single factor will be controlling, nor will the factors necessarily be weighted the same in each case. Further, credit unions are strongly advised to consult with DIFS before organizing, investing in, or loaning to an entity which does not very clearly meet the statutory definition of a CUSO. A credit union may request a “no objection” letter from the Director. The request must:

- Carefully describe the proposal.
- Specifically state the facts involved.
- Propose a list of appropriate factors to be considered in making a determination.
- Provide an analysis of those factors to the factual circumstances.
- Offer a proposed conclusion on the permissibility of the request.
- Include a copy of any legal opinion obtained, as well as any other relevant materials.

As provided for in MCL 490.401(2)(gg), domestic credit unions have the power to invest in or loan to a CUSO “if the CUSO allows the director to conduct an examination of the CUSO to the same extent that the director is authorized to examine credit unions and agrees to make any reports to the director that he or she requires.” Further, “the director shall determine the activities and services that fall within the meaning of this subdivision”, in addition to the activities described in section 407(1) and (2). Among other eligible activities a CUSO might be ‘primarily engaged in’ is “(l) Investment management, investment research, and other full-service broker-dealer services, but not underwriting of investment securities.” (MCL 490.407(1)).

In situations where a parent CUSO is used to manage investments in subsidiary CUSOs, DIFS considers section 407(1)(l) to be applicable only if all of the underlying investments are permissible direct investments of the credit union. In the case of a parent/subsidiary CUSO situation, the CUSO in which the investment is made, as well as all subsidiary CUSOs, must meet the MCUA definition of a CUSO (MCL 490.401(l)) and comply with all provisions of the MCUA (including those found in MCL 490.401(2)(gg) and MCL 490.407(3)) which outlines certain other conditions and requirements.

Credit union boards are also reminded of their obligation to ensure the credit union complies with all other applicable sections of the MCUA, including MCL 490.407(4-7).

Safety and Soundness and Examination Considerations

Due Diligence / Documentation: It is the responsibility of the investing credit union to maintain evidence of the compliance of each of its CUSO investments. Therefore, the investing credit union must, at a minimum, maintain written evidence that:

- Each CUSO meets the definition of a CUSO as outlined in the Michigan Credit Union Act (with careful analysis of the activity in which they ‘primarily engage’).
- Each CUSO has agreed in writing to be subject to examination by DIFS and provide any reports the director may require pursuant to MCL 490.401(2)(gg).
- Each CUSO is adequately capitalized or has a reasonable plan for such (if it is newly formed) pursuant to MCL 490.407(3)(a).
- Each CUSO is structured and operated as separate legal entity from the credit union which limits the credit unions liability to not more than the amount invested or loaned as required pursuant to MCL 490.407(3)(b) and (c).
- Each CUSO has agreed in writing to provide the credit union quarterly financial statements and a copy of its annual CPA audit as required pursuant to MCL 490.407(3)(d) and (e).
- Each CUSO has explicitly agreed to operate in compliance with all applicable federal and state laws as required pursuant to MCL 490.407(3)(f).
- The credit union has established a limit on the percentage of assets for investments/loans to each CUSO as required pursuant to MCL 490.407(4). Credit unions must also document their concentration limit for aggregate CUSO investments relative to assets and net worth.

- The credit union has adhered to the prohibitions and requirements set forth in MCL 490.407(5) to (7).

Investment Risk: Credit unions should carefully analyze the quarterly financial statements provided by CUSOs and recognize any reasonably foreseeable loss to ensure that the credit union's financial statements fairly represent the credit union's financial condition. Reasonable concentration limits must be set by credit union management to ensure that no individual CUSO investment loss (nor CUSO portfolio value decline) may jeopardize the overall safety or soundness of the credit union's financial standing or net worth adequacy. Other than temporary impairments (OTTIs) must be recognized timely.

Examination Implications: Credit union management should be prepared to supply DIFS examination staff with evidence of CUSO investment value to support any such asset claimed on the credit union's balance sheet. Examination scope related to any CUSO investment may be expanded when conditions warrant, especially when concentrations are identified with any individual investment or aggregate CUSO investments relative to a credit union's overall risk profile and net worth strength. For 'investments' as to which tangible value cannot be satisfactorily evidenced, entries may be made for examination purposes to recognize such foreseeable losses (e.g., the Asset Classification performed may include such investments of note and/or entries made to net worth for examination purposes when reaching conclusions about the overall financial soundness of the institution and/or relative CAMELS ratings).

The results of risky CUSO investments may have an impact on the credit union's actual safety and soundness, and thus CAMELS ratings. Impermissible investments will require a divestiture plan and may also result in other supervisory/regulatory consequences.

Credit union management and the board of directors must ensure that thorough due diligence is performed prior to any investment in a CUSO, and that continued monitoring of the CUSO and its effect on the credit union's overall operations is maintained. The board of directors must demonstrate a fundamental understanding of the risk characteristics of each investment activity of the credit union. Individuals to whom specific investment authority has been delegated must demonstrate a full understanding of the characteristics and associated risks of each type of investment activity, maintain evidence of full compliance with all related regulation/guidance and demonstrate sound controls and ensure monitoring of the safety and soundness of all CUSO-related investment activity.

Any questions regarding this Bulletin should be directed to:

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/s/

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