

Chapter 32

INCIDENTAL POWERS

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Chapter 32

INCIDENTAL POWERS

Examination Objectives

- Determine whether the legal authority for the expanded activities exists under Part 721 of the *NCUA Rules and Regulations*
- Evaluate adequacy of policies, practices, procedures, and internal controls over the incidental powers activity
- Determine that personnel operate in conformance with sound business practices and board approved guidelines
- Determine that management has performed the necessary due diligence for the services and products offered under the incidental powers provision
- Assess promptness of corrective action initiated by management when deficiencies or violations in policies, practices, procedures, or internal controls arise

Associated Risks

Activities permitted by the incidental powers provision could subject the credit union to one or more of the seven risks. Some activities involve more risk than others; therefore, the risk to the credit union largely depends on the type of activity chosen.

Overview

An activity under the incidental powers provision, which applies to federal credit unions, is one that is necessary or requisite to enable the credit union to effectively carry on the business for which it was incorporated (§721.2). An activity meets the definition of an incidental power if it meets the following three-prong test:

- Convenient or useful in carrying out the mission or business of credit unions consistent with the FCU Act;
- Functional equivalent or logical outgrowth of activities that fall within the mission or business of credit unions; and
- Involves risks similar in nature to those already assumed as part of the business of credit unions.

Management is responsible for developing proper safeguards such as management oversight, internal controls, and quality control. Credit

unions must examine the strategic, reputation, transaction, and compliance risks before engaging in any new activity. Management must exercise due diligence before devoting resources to a new activity or entering into any third-party arrangements. Credit unions must adjust their risk management process and insurance coverage to correlate with the additional risk of any new activities.

Examiner Review

Examiners should tailor their incidental powers review to the existing and potential risks associated with the activity. At a minimum, examiners should review the credit union's analysis supporting its decision to engage in the activity. This may include reviewing the business plan, applicable contracts (including recourse and/or liability position), legal opinions, licensing and insurance requirements, feasibility studies, and cost benefit analysis.

The following may assist the examiner in determining the scope:

- Concerns noted in previous examination or audit reports;
- Interviews with management and staff to determine the extent and quality of management's due diligence regarding the credit union's products, services, systems, and risk mitigation procedures;
- Review of internal audit work, if available;
- Review of the credit union's internal controls; and
- Review of the credit union's periodic analysis of the vendor's financial and contractual performance.

Categories of Preapproved Activities

Before engaging in any of the activities authorized under incidental powers, credit unions must comply with applicable conditions or restraints established by federal and state law, NCUA regulations, and legal opinions. Credit unions must further ascertain whether they need to obtain licenses or meet other legal requirements before engaging in an activity.

The following broad categories are preapproved activities under the incidental powers provision:

- **Certification services** – when the credit union attests or authenticates a fact for its members' use. Certification services may

include notary services, signature guarantees, certification of electronic signatures, and share draft certifications.

A credit union acting as a certification authority bears similar risks to a notary's risk of improper verification, or to those risks inherent to providing electronic services. The credit union's policies should set forth identification and verification methods.

- **Correspondent services** - when the credit union provides services it is authorized to perform for its members, or as part of its operation, to other credit unions. These may include loan processing, loan servicing, member check cashing services, disbursing share withdrawals and loan proceeds, cashing and selling money orders, performing internal audits, and automated teller machine deposit services.

Correspondent services entail the same risks as those assumed by the credit union for its own operation. Parties to a correspondent arrangement must establish a written agreement addressing the credit unions' responsibilities under the service arrangement. Correspondent relationships allow credit unions to assist other credit unions lacking resources or expertise; however, credit unions cannot be in the business of managing other credit unions.

- **Electronic financial services** - any services, products, functions, or activities the credit union is otherwise authorized to perform, provide, or deliver to its members but performed through electronic means. Electronic services may include automated teller machines, electronic funds transfers, online transaction processing through a website, website hosting, account aggregation, or Internet access to perform services or deliver products to members.

Credit unions are authorized under incidental powers to engage in new activities or services due to the changing commercial environment, such as Internet access. By providing financial services over the Internet, the credit union confronts risks similar to those associated with providing these services by electronic means. Members using the credit union's Internet access and transactional web site can retrieve account information and process transactions just as they would through tellers, ATMs, or audio response

systems. Additional information may be found in the Management chapter of this Guide.

- **Excess capacity** - the excess use or capacity remaining in facilities, equipment, or services properly invested in or established by the credit union, in good faith, with the intent of serving its members, and which it reasonably anticipates will be taken up by future expansion of services to its members. Credit unions may sell or lease the excess capacity in facilities, equipment or services such as office space, employees and data processing.

Opportunities to sell excess capacity may involve leasing office space, sharing employees, or using data processing systems to process information for third parties. Incidental powers permit the sale of excess capacity under two conditions: (1) the credit union properly established the service or made the investment with the good faith intent of serving its members; and (2) the credit union reasonably anticipates that the future expansion of services to its members will take up the excess capacity. Credit unions investments in fixed assets are limited by §701.36 of the NCUA Rules and Regulations.

- **Financial counseling services** - advice, guidance, or services the credit union offers to its members to promote thrift, or to otherwise assist members on financial matters. These services may include income tax preparation, electronic tax filing, estate and retirement planning, investment counseling, or debt and budget counseling.

Depending on the activity, a credit union may be subject to other federal, state, or local laws. The credit union must apprise itself of any legal requirements associated with the activity.

This category applies only to financial counseling provided by a credit union to its members. It does not encompass activities that require SEC registration as a broker, dealer, or investment adviser. A credit union may be able to make these services available to its members from a third party under its authority to act as a finder, discussed in the next section.

- **Finder activities** - when the credit union introduces, or otherwise brings together, outside vendors with its members to enable both parties to negotiate and consummate transactions. Finder activities may include offering third-party products and services to members through the sale of advertising space on the credit union's website, account statements, and transaction receipts, or by selling statistical or consumer financial information to outside vendors to facilitate the sale of their products to members.

Credit unions may act as an intermediary between their members and outside parties for the sole purpose of bringing the parties together. Although identifying particular vendors to its membership could subject a credit union to reputation risk, the credit union does not represent the vendor or the member in either the negotiation process or the resulting transaction. Finder activities differ from the category of marketing activities because, as the "finder," a credit union simply identifies an outside party with a product or service it believes its members would have interest in obtaining. Marketing activities consist of a credit union promoting or marketing its own products and services.

Section 721.3(f) does not limit the types of products credit unions may introduce to their members. Rather, a credit union must exercise judgment and due diligence when introducing or bringing together an outside vendor with its members. For example, if a federal credit union finds, under its finder authority, investment advisors or brokers for its members and receives commissions from these third-party vendors, then it must comply with all applicable state and federal laws, regulations and guidance. It should identify all regulatory restrictions that may apply to commissions or fees paid in conjunction with the sale of mutual funds, or other nondeposit investment products.

Credit unions must comply with NCUA's Privacy of Consumer Financial Information regulation (§716), the Fair Credit Reporting Act, and any applicable state laws before selling or otherwise communicating consumer information to third parties.

- **Loan-related products** - products, activities or services the credit union provides to its members in a lending transaction that protects

it against credit-related risks, or are otherwise incidental to its lending authority. These may include debt cancellation agreements, debt suspension agreements, letters of credit and leases. The Loan chapter of this Guide contains additional information on debt cancellation/suspension agreements.

- **Marketing activities** - activities or means used to promote membership in the credit union and the products and services it offers. These may include advertising and other promotional activities such as raffles, membership referral drives, or sponsorship of civic and charitable causes. Credit unions must comply with NCUA's Privacy of Consumer Financial Information regulation (§716).
- **Monetary instrument services** - services that enable members to purchase, sell, or exchange various currencies. These may include the sale and exchange of foreign currency and U.S. commemorative coins. Credit unions may maintain deposits in foreign financial institutions to facilitate member transactions, including members' transfers and negotiation of checks denominated in foreign currency, or engage in monetary transfer services for their members. However, credit unions may not maintain foreign accounts for speculative purposes. Credit unions involved in foreign currency transactions must establish appropriate controls to mitigate exchange risk.
- **Operational programs** - programs offered by credit unions to establish or deliver products and services that enhance member service and promote safe and sound operations. These may include electronic funds transfers, remote tellers, point of purchase terminals, debit cards, payroll deduction, pre-authorized member transactions, direct deposit, check clearing services, savings bond purchases and redemptions, tax payment services, wire transfers, safe deposit boxes, loan collection services, and service fees.
- **Stored value products** – an alternate media to currency in which the credit union transfers monetary value to the product and creates a medium of exchange for its members' use. Examples include stored value cards, public transportation tickets, event and

attraction tickets, gift certificates, prepaid phone cards, postage stamps, electronic benefits transfer script, and similar media.

- **Trustee or custodial services** - where the credit union is authorized to act under any written trust instrument or custodial agreement, created or organized in the United States, and forming part of a pension or profit-sharing plan, as authorized under the Internal Revenue Code. These services may include acting as a trustee or custodian for member retirement and education accounts.

Credit unions can provide individual retirement accounts (IRAs), education saving accounts (Roth IRAs), and other savings opportunities as provided in Part 724 of NCUA's regulations. However, the FCU Act does not provide the authority for federal credit unions to act in a fiduciary capacity for their members; therefore, federal credit unions may not offer full trust company services to their members.

Non Preapproved Activities

The NCUA Board intends the activities listed under the broad categories of the incidental powers rule as illustrations, not an exhaustive list of what is permissible. Although NCUA does not require federal credit unions to seek NCUA's approval before engaging in an activity that is not listed, they should be cautious.

If it is not clear that an activity falls within one of the categories, a credit union should consult informally with NCUA's Office of General Counsel or formally request a legal opinion from the Office of General Counsel. Section 721.4 specifically provides for seeking an advisory opinion from NCUA's Office of General Counsel, which has the authority to issue legal interpretations of the rule. The rule also provides a credit union the option of applying to the NCUA Board, which may subsequently result in a rule amendment, but is likely to be a lengthy process.

Workpapers and References

- References
 - *NCUA Rules and Regulations*
 - §721 - Incidental Powers
 - §701.36 – FCU Ownership of Fixed Assets

§716 – Privacy of Consumer Financial Information
§724 – Trustees and Custodians of Pension Plans