

May 1, 2008

James E. Forney, Superintendent
Credit Unions Division
Iowa Department of Commerce
200 East Grand Avenue, Suite 370
Des Moines, Iowa 50309-1827

Re: Conflict of Interest under Member Business Loan (MBL) Rule.

Dear Mr. Forney:

You have asked if an inherent conflict of interest exists that prevents credit unions from using the services of a particular Credit Union Service Organization (CUSO) to satisfy the MBL rule's direct experience requirement. If an inherent conflict of interest exists, you also asked what changes or modifications the CUSO would need to make to be considered an independent third party. Finally, you would like a clarification of the proper use and citing of the preamble accompanying the publication of a rule in the enforcement of the regulation. Generally, there is not an inherent conflict of interest where a credit union uses a CUSO to meet its MBL direct experience requirement, provided the CUSO is independent as to each transaction. Preamble language, among other things, can be used to clarify a rule's compliance requirements.

The MBL rule allows credit unions to use a third party to meet the minimum two-year direct experience requirement if the third party is independent from the transaction. Generally, a third party is considered to be independent from the transaction if, with respect to a loan it is responsible for reviewing, it does not have a participation in the loan or an interest in the collateral securing the loan. Additionally, credit unions are able to use a third party to meet the experience requirement when:

- the third party provides the credit union with a service related to the transaction, for example, loan servicing;
- the third party provides the required direct experience for, and purchases a loan or participation interest in, a loan originated by the credit union that the third party reviewed; or,
- the third party, though not independent from the transaction, is a CUSO in which the credit union has a controlling financial interest as determined under Generally Accepted Accounting Principles.

Your letter indicates the CUSO "does not participate in any of the funding of the MBL loans or have any interest in the collateral securitizing any of the loans." 12 C.F.R. §723.5(a), (b). Also, it "is not selling a loan, does not participate in

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funding the loan, and does not have a security interest in the loan collateral.” Generally, the presence of these factors would enable credit unions to still use a CUSO to meet its direct experience requirement. We noted, however, the CUSO appears to be compensated on a fee basis, collecting fees in connection with origination, servicing, participations, referral and document preparation. Under this fee structure, the CUSO appears to be paid only or primarily when a loan is funded. This situation creates an inherent conflict of interest as the CUSO has a direct interest in recommending a loan be funded and not denied. We recommend you address any questions or concerns regarding the nature of this arrangement or specific transactions with the appropriate regional director.

The preamble to a rule serves several functions. It explains the basis and purpose of the regulatory text for those who must comply with the rule; for a court where a rule is challenged or an enforcement action appealed; and for historical purposes. Generally, the preamble provides a history of the issues addressed by the rulemaking, justifies the agency’s action, and elaborates on rule text, for example, by providing clarifying information about the rule’s compliance requirements. Linda McCloud, *An Introduction to Regulation Writing* 59-60 (2006).

We hope you find this explanation on the issues you raised to be helpful.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

GC/LKD:bhs
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cc: Keith Morton, Region IV Director