

# CREDIT UNION NewsWatch



FEBRUARY 21, 2011

Legislation, Regulation, And Innovation Online From the Credit Union National Association



## Doubt Cast on Interchange Rule

*Allied CU of Stockton, Calif. President/CEO Frank Michael (far left) urges lawmakers to stop, study and start over with the interchange rulemaking process at a House hearing last week. Several lawmakers also targeted a possible delay of implementation. (CUNA Photo)*

The impact that proposed interchange fee regulations could have on credit unions and small issuers in general, and the viability of the upcoming July interchange rule deadline, came under the scrutiny of hearings in both the House and Senate last week. CUNA testified before the House panel and was the only group to represent credit unions.

Legislators from both parties called for a delay in interchange implementation during a Thursday House financial institutions and consumer credit subcommittee hearing on interchange issues, and Federal Reserve Governor Sarah Bloom Raskin in House testimony said that the Fed would delay its rulemaking process if directed to do so by Congress.

The Senate hearing took a broader look at the Dodd-Frank Wall Street Reform Act implementation, but Republican and Democratic lawmakers, including House subcommittee Chairman Shelley Moore Capito (R-W. Va.) and Senate Banking Committee leader Tim Johnson (D-S.D.), expressed concern over the impact that the interchange provisions could have on small issuers. Fed Chairman Ben Bernanke, when questioned by several senators, admitted that credit unions and other small institutions could still be impacted by the interchange provisions, despite the law's requirement that the Fed plan exempts financial institutions

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## Incentive Compensation Addressed by NCUA

The National Credit Union Administration (NCUA) proposed enhanced disclosure and reporting requirements for incentive-based compensation arrangements at its Feb. 17 open meeting. If adopted, the plan would require all credit unions with more than \$1 billion in assets to disclose their executive incentive plans annually.

Credit unions with over \$10 billion in assets will be subject to additional requirements. Those so-called "larger covered financial institutions" would need to meet certain provisions on deferral of incentive-based compensation for executive officers, including a 50% deferral of all cash bonuses for at least three years. At the end of that period, the credit union must adjust a bonus to reflect any losses suffered by the institution.

The larger credit unions also must identify additional personnel, in addition to executive officers, "who have the ability to expose the institution to possible losses that are substantial." The NCUA regulations would also prohibit incentive-based payment plans that can serve to encourage "inappropriate risk taking."

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A primer for credit unions



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# UBIT Primer: Where Do Issues Stand for CUs?

Two recent court cases involving state-chartered credit union Unrelated Business Income Tax (UBIT) have given greater clarity to which credit union products are and are not subject to UBIT. State-chartered credit unions are subject to UBIT on income from business activities that are regularly carried on but are not “substantially related” to the credit union’s tax-exempt purpose, under sections 511 through 514 of the



Michael Edwards,  
CUNA Senior Assistant General Counsel

Internal Revenue Code. (See first resource link for CUNA E-Guide on UBIT.)

State-chartered credit unions’ tax-exempt purposes vary by state, but state credit union acts (see second resource link) typically define “credit union” to mean a not-for-profit cooperative chartered to promote thrift and provide loans to members at reasonable rates of interest, as well as sometimes other purposes. Whether a state-chartered credit union must report UBIT

liability to the Internal Revenue Service (IRS) by filing a Form 990-T and paying UBIT depends on whether its business activities are “substantially related” to its tax-exempt purposes under state law.

Until recently there were no court decisions on credit union UBIT and the IRS took a very restrictive position regarding what was “substantially related.” The two recent court cases—*Community First CU v. United States* and *Bellco CU v. United States*—have helped clarify what credit union activities are subject to UBIT, and these cases may qualify as “substantial authority” sufficient for a state-chartered credit union to take the position that it does not need to report on its Form 990-T or pay UBIT on income from sales of products such as credit insurance and securities investments. See I.R.C. § 6662 (imposing penalties on tax underpayments when the taxpayer does not have “substantial authority”).

In recent years, IRS has taken the position through a series of Technical Advice Memoranda (TAMs) that sales of products such as credit insurance were not “substantially related” to credit unions’ tax-exempt purposes and were therefore subject to UBIT. (See third resource link.) Two credit unions, Community First CU of Appleton, Wisconsin and Bellco CU of Greenwood Village, Colorado, challenged the IRS interpretation of the law by filing lawsuits in federal district court claiming refunds on UBIT paid in prior years.

The UBIT Steering Committee (consisting of representatives from CUNA, AACUL, NASCUS, and CUNA Mutual Group) supported Community First CU and Bellco CU at all stages of this UBIT refund claim litigation.

## The Community First Case

Community First CU, the Wisconsin-chartered credit union, filed its UBIT refund lawsuit against the United States in January 2008 seeking a refund of \$54,604 in UBIT that it paid on credit life insurance, credit disability insurance, and Guaranteed Asset Protection (GAP) products in 2006. The credit union asked for a jury trial.

Wisconsin defines “credit union” (and therefore also defines the credit union’s tax-exempt purposes for UBIT) as follows:

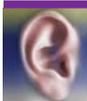
“Credit union” means, except as specifically provided under §§ 186.41(1) and 186.45(1), a cooperative, non-profit corporation, incorporated under this chapter to encourage thrift among its members, create a source of credit at a fair and reasonable cost, and provide an opportunity for its members to improve their economic and social conditions.” Wis. Stat. § 186.01(2).

The trial began on May 11, 2009 and ended on May 14, 2009. The jury found that all three products at issue—credit life, credit disability, and GAP—were substantially related to the credit union’s tax-exempt purpose and were therefore not subject to UBIT. On May 21, 2009, the Department of Justice filed a motion asking the judge to overrule the jury’s verdict and issue a “Judgment as a Matter of Law” that the credit union products were subject to UBIT.

On July 14, 2009 the court issued a decision upholding the jury’s verdict, noting that the jury was “well within the bounds of reason” to conclude that credit insurance and GAP promoted thrift and that “[t]he possibility that other kinds of insurance may have accomplished the same goals at a lower price does not necessarily mean a member is not engaged in ‘thrift’ when he endeavors to insure against possible losses.” A copy of that ruling is available to CUNA members. (See fourth resource link.) Community First received its full refund request of \$54,604.

## The Bellco Case

Bellco CU, the Colorado-chartered credit union, filed its refund case against the United States in May 2008 asking for a refund of \$199,293 in UBIT taxes it paid on income from



## UBIT Primer: Where Do Issues Stand for CUs?

sales of credit life and credit disability insurance, and income related to the sale of securities and similar financials services to members during the tax years of 2000, 2001, and 2003. Also at issue was whether income from sales of accidental death and dismemberment (AD&D) insurance products sold to Bellco's members by a third-party vendor should be treated as "royalties" not subject to UBIT, as well as whether UBIT applied to income from credit insurance sold by a CUSO (35%-owned by Bellco), in connection with an indirect lending program, to Bellco's members and members of other credit unions. The credit union claimed a net loss on the sale of the relevant products—and therefore paid no UBIT tax on those products—for years 2002, 2004, 2005 and 2006. The case was tried before a federal judge in Denver, Colo.

Colorado defines "credit union" (and therefore also defines the credit union's tax-exempt purposes for UBIT) as follows:

"A credit union is a cooperative association, incorporated pursuant to this article for the twofold purpose of promoting thrift among its members and creating a source of credit for them at fair and reasonable rates of interest." Colo. Rev. Stat. § 11-30-101(1)(a).

The judge issued two relevant rulings in the Bellco case: (1) a November 2009 summary judgment ruling holding that Bellco's income from sales of financial products such as mutual funds, stocks, annuities, etc. to members through as CUSO was not subject to UBIT; and (2) an April 2010 "findings of fact and conclusions of law" holding that Bellco's sales of credit insurance were not subject to UBIT and also that Bellco's commissions from its third-party vendor's sales of AD&D insurance to Bellco members were "royalties" not subject to UBIT. (See fifth and sixth resource links.)

The U.S. Department of Justice filed documents that would

have allowed it to appeal these rulings to the 10th Circuit Court of Appeals, but later abandoned the appeal request, meaning that the lower court's rulings stand. Bellco CU received a full refund earlier this year.

### Conclusion

Many state credit union acts define the term "credit union" similarly to Wisconsin and Colorado. However, each individual state-chartered credit union—in consultation with its legal, tax, and accounting advisors—must determine for itself whether the Community First CU and Bellco CU decisions constitute "substantial authority" sufficient for the credit union to not pay UBIT on sales of the products addressed in these cases, based on its particular facts and circumstances. Credit unions must discuss this with their own legal, tax, or accounting professionals to determine what this means for their credit union. 🏠

### CUNA E-Guide on UBIT

[http://cuna.org/compliance/member/eguide/eguide\\_ubit.html](http://cuna.org/compliance/member/eguide/eguide_ubit.html)

#### State-chartered credit unions' tax-exempt purposes

[http://cuna.org/gov\\_affairs/state\\_affairs/statecu\\_acts.html](http://cuna.org/gov_affairs/state_affairs/statecu_acts.html)

#### IRS TAMs

[http://www.cuna.org/compliance/member/eguide/eguide\\_ubit\\_latest.html](http://www.cuna.org/compliance/member/eguide/eguide_ubit_latest.html)

#### Community First CU v. U.S., 2009 U.S. Dist. LEXIS 60283, 2009 WL 2058476, 104 A.F.T.R.2d 5346 (E.D. Wis. July 14, 2009).

[http://www.cuna.org/compliance/member/eguide/eguide\\_ubit\\_latest.html](http://www.cuna.org/compliance/member/eguide/eguide_ubit_latest.html)

#### Bellco CU v. U.S., 2009 U.S. Dist. LEXIS 106087, 2009 WL 3838778, 104 A.F.T.R.2d 7337 (D. Colo. Nov. 12, 2009).

[http://cuna.org/compliance/member/download/eguide\\_ubit\\_bellco1109.pdf](http://cuna.org/compliance/member/download/eguide_ubit_bellco1109.pdf)

#### Bellco CU v. U.S., 2010 U.S. Dist. LEXIS 33047, 2010 WL 1435352, 105 A.F.T.R.2d 1778 (D. Colo. Apr. 2, 2010).

[http://cuna.org/compliance/member/download/eguide\\_ubit\\_bellco0410.pdf](http://cuna.org/compliance/member/download/eguide_ubit_bellco0410.pdf)

#### IRS Publication No. 598, Tax on UBIT-Exempt Organizations

<http://www.irs.gov/pub/irs-pdf/p598.pdf>

## Director Fin. Lit.: Is Policy Simple?

In a Letter to Federal Credit Unions (11-FCU-02), the National Credit Union Administration (NCUA) clarified its newly adopted rule on the fiduciary duties of boards of directors of federal credit unions, which added a specific requirement that board members be able to understand financial statements.

The letter notes that it is not the NCUA's intent to increase examiner scrutiny of the financial skills of particular directors. Rather, examiners "will evaluate whether the credit union has a policy in place to make available the appropriate training to enhance the financial knowledge of the directors." It then provides three bullet points on train-

ing policy. (Use resource link below.)

CUNA Senior Vice President of Compliance Kathy Thompson says that following those three bullets might work for smaller, "straightforward" credit unions. But, she adds, NCUA will expect more complex credit unions to adopt policies that (a) reflect a recognition of activities that can present greater risk to the credit union, and (b) the commitment that your directors will be trained on how these activities can impact the credit union's financial statements.

### Letter to FCUs 11-FCU-02

<http://www.ncua.gov/letters/2011/FCU/11-FCU-02.pdf>

# Be Ready

## CUNA Volunteer Institute

**Prove you're a qualified credit union volunteer.**

**NEW! CUNA Credit Union Board Financial Literacy Workshop: April 30, 2011**

Attend the recently announced CUNA Volunteer Institute pre-conference workshop and gain the knowledge necessary to comply with the newly issued NCUA rule.

**Attend the pre-conference workshop and you'll:**

- Understand what it means to be financially literate
- Make sense of the balance sheet and income statement
- Understand capital
- Explore major risks every credit union faces
- Ensure adequate internal controls over risk

**Successfully complete the onsite exam and receive your CUNA Board Financial Literacy Certificate and pin.**

**CUNA**  
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May 1-4, 2011  
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# >> Notes Bearing Interest

## CU Online Presence to Grow with Debut of *aSmarterchoice.org*



Potential credit union members, national and local press, and personal computer users will have greater access to the latest credit

union information when aSmarterChoice.org, a new website developed by CUNA and state credit union leagues, launches on Feb. 28.

The release date coincides with the start of CUNA's 2011 Governmental Affairs Conference, which will take place

between Feb. 28 and March 3 in Washington, D.C.

The free website will feature a comprehensive credit union locator that will allow users to view the location of any credit union they choose, regardless of their charter, affiliation, size or business model. The website will also include basic information about credit unions and the latest national, regional and local news coverage of credit unions.

CUNA President/CEO Bill Cheney commented on the new site, which gives the credit union movement a sustainable online presence that can continually drive credit union membership growth. "New technology can give us an affordable opportunity to be even more effective than a brand campaign," Cheney said. 🏠

## Doubt Cast on Interchange Rule

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with under \$10 billion in assets from interchange fee charge limits.

The call for an interchange delay was also raised during that hearing.

The interchange fee limits proposed by the Fed could lower the amount that financial institutions receive to as little as seven cents per debit card purchase.

Allied CU President/CEO Frank Michael, who testified before the House subcommittee on behalf of his Stockton, Calif.-based credit union and CUNA, urged lawmakers to stop, study and start over with the interchange rulemaking process.

Michael, whose testimony was picked up by national media, said that his credit union and others across the country could be forced to charge their members for debit card access or simple checking accounts, two circumstances that may push low-income credit union members out of the financial system altogether.

CUNA President/CEO Bill Cheney said that CUNA was encouraged by the tenor of both hearings and said that the Hill discussions will increase pressure on Congress and the Fed to put on the brakes and rethink their approach.

The Fed proposal will remain open for public comment until Feb. 22, and, if approved, could come into effect in July. 🏠

📄 **CUNA Issue Summary: Interchange**  
[http://www.cuna.org/gov\\_affairs/legislative/issues/download/interchange\\_fees.pdf](http://www.cuna.org/gov_affairs/legislative/issues/download/interchange_fees.pdf)

## Incentive Compensation Addressed by NCUA

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The compensation arrangement reforms are required under the Dodd-Frank Wall Street Reform Act.

Though the compensation deferral rules have been limited to credit unions with over \$10 billion in assets, a similar rule proposed by the Federal Deposit Insurance Corp. would apply these rules to for-profit institutions with \$50 billion or more in total assets. CUNA has questioned the \$10 billion threshold, noting that credit unions are not known to have engaged in the kind of sketchy incentive-compensation practices that the Dodd-Frank law seeks to address.

The NCUA also addressed corporate federal credit union chartering guidelines, credit ratings, interest-rate ceilings, and the status of its insurance funds during the meeting. Use the resource link below for more.

📄 **CUNA Summary of NCUA Actions**  
[http://www.cuna.org/reg\\_advocacy/member/ncua\\_board/ncua\\_boardsumm.html](http://www.cuna.org/reg_advocacy/member/ncua_board/ncua_boardsumm.html)



# >> Notes Bearing Interest

## The Front Burner

The most viewed news stories on [cuna.org](http://cuna.org) during January 2011 reveal the hottest issues for credit unions. Access the complete stories and register to receive daily credit union news headlines at [www.cuna.org/newsnow/top10](http://www.cuna.org/newsnow/top10).

### 10 CU Times' parent co. files for Ch.11 bankruptcy

Summit Business Media, the parent company of trade newspaper Credit Union Times and 12 other business-to-business publications, announced it was filing for a Chapter 11 reorganization in a U.S. Bankruptcy Court in Wilmington, Del.

### 9 Four banned from future FCU work

Four former credit union employees have been banned from future work at any federally insured financial institution under prohibition orders issued by the National Credit Union Administration.

### 8 CU-to-bank conversions declining

2010 was a year without a single credit union-to-bank conversion, and it arrived on the heels of two years in which only one such conversion per year occurred. News Now, sniffing a trend, decided to look closer and noted a decline in conversions since they peaked at eight conversions in 2001.

### 7 Technology 2011: What's next?

Just three years ago, someone who mentioned "twitter" or "tweet" in a business meeting would draw blank stares. Today "Twitter" and "tweet" are part of the everyday lexicon, and using Twitter is an important branding vehicle for many companies, including credit unions.

### 6 NCUA applies salary freeze to part of work force

The National Credit Union Administration said it will apply President Barack Obama's recent executive-ordered federal pay freeze to those agency employees whose salary increases were not negotiated under existing union contracts.

### 5 Truth-in-Savings changes finalized by NCUA

The National Credit Union Administration on Jan. 13 finalized a rule that requires credit unions to disclose overdraft and returned item (NSF) fees on their members' periodic statements.

### 4 CUNA concerned by CARD Act creditworthiness standard

CUNA in a recent comment letter said it is concerned by a Federal Reserve proposal that would require creditors to consider only an individual credit applicant's ability to make payments, and not other household income, when determining an individual's creditworthiness.

### 3 CUNA unveils extensive guidance on CU exam issues

After an exhaustive look at credit unions' increasing frustrations, CUNA has developed a bill of "examination rights," which is detailed and cross-referenced to the National Credit Union Administration's own examiner guide.

### 2 Supreme Court's bankruptcy ruling a 'positive for CUs'

An 8-to-1 ruling by the Supreme Court of the U.S. in favor of a creditor who contested a bankruptcy filer's disposable income deduction is a "positive for credit unions" or any creditor of unsecured debt in a Chapter 13 bankruptcy, according to Michael Edwards, CUNA counsel for special projects.

### 1 What CUs should do in 2011 - CUNA economist

CUNA's 2011 Economic and Credit Union Forecast reflects expectations that the economy will improve, but the level of growth associated with the rebound will be lower than what is typically seen in an economic recovery.

## Corporate CU Realignment Must Include Flexibility

CUNA President/CEO Bill Cheney reiterated recently that CUNA will work with the National Credit Union Administration (NCUA) and various stakeholders to determine how individual credit unions can be given the most flexibility as the future structure of the corporate credit union system is decided.



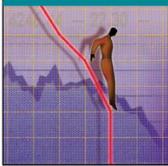
Bill Cheney, CUNA President and CEO

Cheney's statement followed the release of an NCUA letter to corporate credit unions (No. 2011-02). In that letter, the NCUA cautioned that "the concentration of services or the aggregation of service volumes in one entity large enough to introduce systemic risk may create an unacceptable 'too big to fail' scenario."

The letter noted that many have suggested that corporate credit unions or specialized credit union service organizations would benefit from larger client/member bases. While consolidation could promote greater efficiency and improve the long-term viability of the credit union system, consolidation can also be overdone, the NCUA said.

Cheney said CUNA appreciates the NCUA's concerns regarding overconcentration of assets, but warned against allowing the system to become too rigid.

 **NCUA Letter to Corporate CUs No. 2011-02**  
<http://tinyurl.com/4uyad19>



# >> The Marketplace

## CU Fraud-Fighting Works: ID Theft Down 28%

There were three million fewer cases of identity fraud reported in 2010 than in 2009, according to an independently produced consumer survey by San Francisco-based Javelin Strategy & Research. Credit unions with beefed up fraud-fighting efforts will be gratified to know that just such measures by financial institutions were credited as being a factor in the decline.

Javelin noted that use of more stringent criteria to authenticate users and determine credit risk helped to account for 2010's 28% decline in ID fraud. There were 8.1 million fraud victims last year representing \$37 billion; that was down from more than 12 million and \$56 billion in 2009.

However, it is not all good news for consumers. Out-of-pocket expenses for fraud rose significantly—63%, the new study said.



The ID fraud decline is “a testament to the significant efforts businesses, the financial services industry and government agencies are making to educate consumers, protect data, and prevent and resolve identity fraud,” said James Van Dyke, Javelin’s president and founder. But, he noted, the jump in out-of-pocket costs carries a warning to consumers. Don’t put finances “on autopilot or ignore important safeguards,” which can include such things as frequently monitoring

all financial activities, securing computers and paper records, and activating electronic alerts to help prevent fraud and address it quickly when it occurs.

The Javelin survey was sponsored by Fiserv, Intersections Inc., and Wells Fargo & Co. Intersections Inc. is a CUNA Strategic Services provider. 🏠



# >> CUNA Notebook

## How Brand Drives Growth

How does a credit union quantify strengths and weaknesses to assess if its brand is working to drive growth? Clearly in today’s economy a credit union cannot rely on guess work to determine if brand strategy is creating—or stunting—membership and loan growth.

A Feb. 22 CUNA webinar is offering information on:

- ▶ The five deadliest sins of branding;
- ▶ Why your brand may NOT be helping you grow; and
- ▶ Exploring fresh strategies that show a Return on Objectives (ROO) from your brand investments.

The webinar also will review credit union case studies of evolving brand management – growth despite the recession. 🏠

 **CUNA Growth Webinar**  
<http://www.cuna.org/training-education/event/EW12221/>

## Interchange Comments Due

Tomorrow is the last day for public comment on the Federal Reserve Board’s (Fed) proposed rule to regulate debit interchange fee income and debit card routing under the Dodd-Frank Wall Street Reform Act. While the Fed has made some efforts to address a few credit union issues, CUNA is concerned the proposal raises many very serious substantive concerns and is needlessly complex.

CUNA is strongly opposing the proposal as issued and urges all concerned leagues and credit unions to write to the Fed in opposition to the proposal. Comments may be submitted by using CUNA’s Operation Comment via the link below. If commenting directly to the Fed, you must refer to Docket No. R-1404.

 **Interchange Comments Due**  
[apwiz.com/cuna/issues/alert/?alertid=20946616](http://apwiz.com/cuna/issues/alert/?alertid=20946616)