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LEGAL UPDATES AND NEWS

NCUA Board Approves Final Rule Designed to Facilitate Innovation and Fintech Partnerships

On September 21, 2023, the National Credit Union Administration ("NCUA") Board unanimously approved a final rule designed to give federally-insured credit unions additional flexibility to use advanced technologies and to partner with fintechs. The new regulation is designed to facilitate innovation by credit unions in their balance sheet management techniques, while allowing them an opportunity to offer new and enhanced products and services to their members. According to the rule's preamble, the majority of commenters strongly supported the issuance of the rule.

The NCUA envisions the new regulation will permit credit unions to increase their engagement with third parties who offer lending services, and to provide access to a more diversified suite of loan origination channels and markets. The final rule implements these objectives through amendments to its existing rules governing loan participations and the purchase, sale, and pledge of eligible obligations. The new regulation directly addresses credit unions' participation in the types of indirect lending arrangements that have exploded in recent years with the rapid emergence of fintech offerings. The regulation accomplishes this by expanding the definition of an "originating lender" for a loan participation to cover an institution that acquires a loan through an "indirect lending arrangement." This term includes written agreements to purchase loans from the loan originator, where the purchaser makes the final underwriting decision on the loan, and the loan is assigned to the purchaser soon after the credit is extended. Notably, these changes to the loan participations rule equally apply to federally-insured, *state-chartered* credit unions and to federal credit unions ("FCUs").

Regarding the changes to rules regarding purchases of loans from members and other sources, the NCUA generally opted to remove pre-existing prescriptive limitations and specified requirements, such as the five percent cap of the FCU's unimpaired capital and surplus regarding the purchase of loans made to its members (subject to certain exceptions), instead shifting to a risk-focused, principles-based approach. The NCUA's view is that the removal of prescriptive limitations will allow FCUs to establish their own risk tolerance limits and governance policies. The regulation codifies the NCUA's long-standing supervisory expectations regarding credit union loan purchase practices, implementing high-level standards addressing due diligence, risk assessment and risk management, and ongoing monitoring. However, the regulation builds in flexibility by allowing FCUs to tailor these standards to their own risk levels and activities.

The NCUA's embrace of fintech partnerships is notable at a time when the other federal banking agencies have increased scrutiny of those relationships, and have issued public warnings

of the potential risks from such ties. While the NCUA makes clear in its release that it will continue to prioritize safety and soundness considerations for these arrangements, the adoption of the final rule evidences that the agency is actively seeking ways to allow credit unions to offer their members new products and services consistent with their individual risk tolerances. Credit unions should consider the new flexibility permitted by the regulation in deciding whether to engage in new fintech partnerships or offer new products and services to their members.

Credit unions should also understand that in addition to business reasons for fintech partnerships, there are significant legal and regulatory considerations, including: (1) whether the partnership should be established directly with the fintech or indirectly through an investment with a credit union service organization ("CUSO") that offers comparable services; (2) structuring the partnership (whether directly or indirectly) to comply with federal and state financial service laws, depending on the fintech's products and services; (3) negotiating a sufficient partnership agreement that adequately covers topics such as due diligence, control and approval of proposed banking and lending activities, ownership of consumer data, ongoing monitoring and termination of the relationship, and the handling of consumer complaints; and (4) being prepared to perform significant due diligence on the business, operations, and products and services of the fintech, including its ability to safeguard confidential membership information received due to the partnership.

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Luse Gorman routinely advises credit unions on compliance issues and regulatory questions, and counsels those institutions on the impacts of new developments at the federal and state level. If you have any questions related to this Client Alert, please reach out to Brendan Clegg at (202) 274-2034 or by email at bclegg@luselaw.com, Jeff Cardone at (202) 274-2033 or by email at jcardone@luselaw.com or Mike Brown at (202) 274-2003 or by email at mbrown@luselaw.com. To learn more about our firm and services, please visit our website.