

The petitioner also objects to the patient release criteria rule on policy grounds, stating that it creates unwarranted hazards with regard to the radioactive iodine treatment of thyroid patients. The petitioner's concern is that there is no "hard and fast limit on the amount of I-131" administered to an outpatient, and that a licensee must only perform a calculation showing that no one will receive a dose that exceeds a prescribed limit. However, the patient release criteria rule means that patients who are sick, stressed, hypothyroid, potentially nauseous, and highly radioactive are being "sent out the door," where they may come into close contact with family members and members of the public, and although they are supposed to receive instructions on minimizing exposure, may have trouble comprehending and remembering the guidance they are given. The petitioner expresses particular concern regarding how children of released patients will be adequately protected from radiological exposure, stating that children are more radiation-sensitive than adults and deserve more protection. The petitioner also expresses concern that there is a likelihood of vomiting and that, unlike hospital staff who wear protective clothing to protect against radiological contamination encountered while cleaning up, family members caring for patients at home will be unlikely to take such precautions.

The petitioner also claims that during the 1997 rulemaking, when the NRC gave notice of the receipt of the petition for rulemaking, it received numerous adverse comments from the ACMUI, Agreement States, and other commenters. However, according to the petitioner, the NRC proceeded to issue the proposed rule and largely ignored comments that ran counter to the NRC staff's preferred approach. In fact, the petitioner asserts that the notice of the final rule misrepresented critical comments on the release of patients with I-131 in their systems.

The petitioner states that the NRC acknowledged in promulgating the 1997 final rule that family members of patients would receive higher doses of radiation, but justified this in part by arguing that members of the clergy who visit hospitals frequently would receive lower doses of radiation as a result of patients having been sent out of the hospital, and by referring to the emotional benefit of releasing these patients. Specifically, the petitioner asserts that the NRC claimed in the final rule (see, 62 FR 4129) that although individuals exposed to the patient could receive higher doses than if the patient

had been hospitalized longer, "these higher doses are balanced by shorter hospital stays and thus lower health care costs. In addition, shorter hospital stays may provide emotional benefits to patients and their families. Allowing earlier reunion of families can improve the patient's state of mind, which in itself may improve the outcome of the treatment and lead to the delivery of more effective health care."

The petitioner argues, however, that the NRC's reasoning ignored his and other thyroid patients' comments that some "patients may experience greater 'emotional benefit' from knowing that by receiving their treatment as in-patients, they are protecting their families from unnecessary radiation exposure." Moreover, the petitioner is skeptical of the NRC's rationale that releasing patients with treatment doses of radioactivity in their bodies will reduce exposure to clergy who regularly visit hospitals, or hospital orderlies.

Finally, the petitioner takes issue with other aspects that he notes constituted part of the NRC staff's rationale for the patient release criteria rule. Specifically, he contests the NRC's assertion that I-131 treatment for thyroid cancer occurs "probably no more than once in a lifetime," the NRC's implication that no harm is done by exposing family members to the exposure from just one treatment, and the implication that it is not "reasonably achievable" to keep radiation exposure to family members low by treating patients in radioactive isolation.

### The Petitioner's Conclusion

The petitioner concludes that the patient release criteria rule is irredeemably flawed, as was the rulemaking that produced that rule. The petitioner therefore requests that the NRC institute rulemaking to rescind that portion of 10 CFR 35.75 that allows patients to be released from radiological isolation with I-131 in their systems in amounts greater than 30 millicuries. The petitioner requests that this rulemaking be undertaken expeditiously.

Dated at Rockville, Maryland, this 15th day of December, 2005.

For the Nuclear Regulatory Commission.

Annette Vietti-Cook,

Secretary of the Commission.

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## NATIONAL CREDIT UNION ADMINISTRATION

### 12 CFR Parts 701 and 741

#### Third-Party Servicing of Indirect Vehicle Loans

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Notice of proposed rulemaking (NPR).

**SUMMARY:** The NCUA is issuing a proposed rule to regulate purchases by federally insured credit unions of indirect vehicle loans serviced by third-parties. NCUA proposes to limit the aggregate amount of these loans serviced by any single third-party to a percentage of the credit union's net worth. The effect of the proposed rule would be to ensure that federally insured credit unions do not undertake undue risk with these purchases.

**DATES:** Comments must be received on or before February 21, 2006.

**ADDRESSES:** You may submit comments by any of the following methods (Please send comments by one method only):

- *NCUA Web Site:*  
[http://www.ncua.gov/news/proposed\\_regs/proposed\\_regs.html](http://www.ncua.gov/news/proposed_regs/proposed_regs.html). Follow the instructions for submitting comments.

- *E-mail:* Address to [regcomments@ncua.gov](mailto:regcomments@ncua.gov). Include "[Your name] Comments on Advance Notice of Proposed Rulemaking (Specialized Lending Activities)" in the e-mail subject line.

- *Fax:* (703) 518-6319. Use the subject line described above for e-mail.

- *Mail:* Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

- *Hand Delivery/Courier:* Same as mail address.

**FOR FURTHER INFORMATION CONTACT:** Paul Peterson, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540, Matt Biliouris, Program Officer, Office of Examination and Insurance, at the above address or telephone (703) 518-6360, or Steve Sherrod, Division of Capital Markets Director, Office of Capital Markets and Planning, at the above address or telephone (703) 518-6620.

#### SUPPLEMENTARY INFORMATION:

##### A. Background

Indirect lending involves credit union financing for the purchase of goods at the point-of-sale. The merchant, typically an automobile dealer, brings a potential member-borrower to the credit

union and also assists with underwriting. When done properly, indirect lending has certain advantages for credit unions, including possible growth in membership and lending volume. Still, because the dealer's primary interest is in facilitating a vehicle sale and not in careful underwriting, indirect lending poses particular risks to credit unions.

Some vendors offer indirect lending programs in which the vendor manages the credit union's relationship with the automobile dealer and, through loan servicing conducted by the vendor or a related business entity, the credit union's relationship with the member. These vehicle lending programs, referred to in this preamble as "indirect, outsourced programs," carry all the risks of indirect lending programs as well as additional risks.

NCUA is concerned some credit unions may increase risk exposures in indirect, outsourced programs without first conducting adequate due diligence, implementing appropriate controls, and gaining experience with servicer performance. Some credit unions have realized weaker than expected earnings because of participation in these programs. Therefore, the Board has determined that regulatory concentration limits on indirect, outsourced programs are appropriate.

The types of risk associated with these indirect, outsourced loan programs include: (1) Credit risk, (2) liquidity risk, (3) transaction risk, (4) compliance risk, and (5) reputation risk. A credit union should exercise caution and gain experience before significantly growing a portfolio of loans underwritten and serviced by a third party. A credit union's due diligence should include an initial review of each of these risks, as well as ongoing reviews.

**Credit risk.** Both underwriting and post-underwriting factors generate potential credit risk. Credit loss experience may be worse if the indirect, outsourced loan program uses more permissive underwriting criteria than the credit union uses for its direct lending. Post-underwriting, credit loss experience may be worse if the quality of a third-party's servicing is not as good as that of the credit union's own servicing. Credit unions should adopt appropriate metrics (e.g., performance standards) in their servicing agreements to ensure timely servicing and collection performance by the third-party servicer.

**Liquidity risk.** A credit union's liquidity position may suffer if the credit union experiences a sudden increase in indirect, outsourced loans.

Liquidity may also be impaired if an indirect, outsourced arrangement restricts the ability to transfer servicing by imposing a material cost for the transfer, including the loss of a material economic benefit, such as cancellation of an insurance policy. Additionally, loans contractually bound to a third-party servicer may have a more limited market than the market for loans sold with servicing released.

**Transaction risk.** Transaction risk (also referred to as operating or fraud risk) may arise in indirect, outsourced programs because the credit union is relying to a significant extent on the third-party servicer's internal controls, information systems, employee integrity, and operating processes. A credit union's due diligence should include continuing review of each of these areas, as well as the financial condition of the servicer.

**Compliance risk.** Compliance risk in lending programs may arise from violations of, or nonconformance with, consumer protection laws, such as the Truth-in-Lending Act and Fair Debt Collection Practices Act. To the extent a credit union has reduced control and supervision of a third-party servicer's collection activities, a credit union's compliance risk in an indirect, outsourced program may be greater than that of an in-house servicing program.

**Reputation risk.** Reputation risk may result from a third-party servicer's compliance failures or transaction losses. Poor quality servicing, improper collection processes, and questionable or excessive fees assessed against the borrower by the servicer may also alienate members from the credit union and affect the ability of the credit union to maintain existing relationships or establish new ones.

NCUA has discussed sound business practices related to this form of lending in a series of letters to credit unions going back several years. In November 2001, for example, NCUA published NCUA Letter to Credit Unions (LTCU) No. 01-CU-20, *Due Diligence over Third Party Service Providers*, providing minimum due diligence practices over third-party service providers. In September 2004, the Board expressed its concern with specialized lending activities and the associated risks in NCUA LTCU No. 04-CU-13, *Specialized Lending Activities*. That letter discussed three, higher risk lending activities: subprime lending, indirect lending, and outsourced lending relationships, and included three examiner questionnaires so credit unions could see how examiners evaluate the risks in these activities. These two letters are available on

NCUA's Web site at <http://www.ncua.gov/letters/2001/01-CU-20.pdf> and <http://www.ncua.gov/letters/2004/04-CU-13.pdf>, respectively. Members of the public without access to the internet may request copies of letters to credit unions and other NCUA publications by calling NCUA's publication line at (703) 518-6340.

Since the summer of 2004, NCUA has also observed a significant increase in specialized lending activities, including the use of third parties to service indirect vehicle loans. NCUA began collecting indirect loan data from all credit unions beginning with the June 30, 2004, Call Report. The portfolios of credit unions reporting indirect loans increased to \$58 billion (at June 30, 2005) from \$45 billion (at June 30, 2004), a 29 percent increase in one year.<sup>1</sup> Based on supervision and insurance information, the growth in indirect, outsourced vehicle loan programs was even more rapid, and NCUA also detected increasing concentration levels at particular credit unions in these loans. Currently, NCUA estimates there are approximately twenty or more credit unions with more than 100 percent of their net worth invested in indirect, outsourced vehicle loans.

In June 2005, the NCUA Board issued Risk Alert 05-RISK-01 (the Risk Alert), Subject: Specialized Lending Activities—Third-Party Subprime Indirect Lending and Participations, available on NCUA's website at <http://www.ncua.gov/letters/RiskAlert/2005/05-RISK-01.pdf>. The Risk Alert discussed concerns related to subprime, indirect automobile loans underwritten or serviced by third parties. The Risk Alert further discussed due diligence practices and on-going control mechanisms appropriate for such programs.

Despite these NCUA supervision and insurance initiatives, the Board remains concerned that some credit unions engaging in these programs still do not undertake the requisite due diligence to understand and protect themselves from the risks inherent in these programs. In fact, some credit unions with significant concentrations in indirect, outsourced loans have indicated to NCUA their desire to fund new loans even though they have not yet completed the due diligence described in NCUA issuances.

<sup>1</sup> Based on anecdotal information, NCUA believes that the vast majority of these indirect loans are vehicle loans.

## B. Proposed Rule

### 1. General

NCUA proposes a two-step, regulatory concentration limit for indirect, outsourced programs with a waiver provision for higher limits in appropriate cases. The Board believes the proposed rule is necessary to protect the National Credit Union Share Insurance Fund (NCUSIF) from the risks associated with this activity.

For the first 30 months of a new relationship, § 701.21(h)(1) limits a credit union's interest in indirect vehicle loans serviced by any single third party to 50 percent of the credit union's net worth. This permits a credit union to enter and gain experience with a new indirect, outsourced vendor program. After 30 months of experience with that third party's program, the proposed rule permits a credit union to increase its interests in that program to 100 percent of the credit union's net worth.

The Board believes that limits of 50 percent and 100 percent are appropriate, assuming credit unions maintain an adequate due diligence program. As explained below, however, a credit union that can demonstrate appropriate initial and ongoing due diligence may apply for a waiver to obtain higher limits.

In determining these concentration limits, the Board noted that indirect, outsourced programs typically require a credit union to give a third party servicer significant control over the loan assets. For example, the third-party generally makes all contacts with the member-borrowers; determines when the loans are in default; determines the pace of and resource allocation to loan collection, vehicle repossession, and vehicle remarketing; and also controls all the cash flows.

The indirect lending aspect of these programs creates additional loss of control for the credit union, as member-borrower information does not come directly to the credit union but instead is filtered through both the dealer and the vendor. In some of these programs, the third-party also controls the quality of the loan receivables because it dictates the underwriting criteria and processes the loan applications. In addition, some third-party vendors control the insurance coverage associated with these loans. The third-party may even assume some of the credit risk through reinsurance arrangements or stop-loss agreements. All these factors increase a credit union's reliance on the third-party to produce a positive return for the credit union. Some vendors have advertised

these programs in the past by promoting them as "turn-key" and suggesting that credit unions need do very little in the way of due diligence.

The control exercised by the third-party in indirect, outsourced programs is similar to the control exercised by an issuer of an asset backed security (ABS) collateralized by loan receivables. The originator of a pool of loan receivables (e.g., auto loans) sells the receivables into a bankruptcy-remote grantor trust or owner trust (*i.e.*, the ABS issuer). The ABS issuer contracts with a servicer, usually affiliated with the seller (e.g., seller/servicer), to service the receivables, and determines what sort of credit enhancements or insurance will be necessary to support issuance of ABS. The ABS issuer also controls the cash flows. The Board believes the risks to a credit union from indirect, outsourced programs are similar to those posed by the purchase of an ABS investment. Accordingly, in determining appropriate concentration limits for indirect, outsourced vendor loan programs the Board examined established concentration limits for investment in ABS.

Natural person federal credit unions are not authorized to invest in ABS, even highly rated ABS.<sup>2</sup> 12 U.S.C. 1757. National banks may invest in ABS, but the Office of the Comptroller of the Currency (OCC) limits a bank's aggregate investments in ABS issued by any one issuer to 25 percent of capital and surplus.<sup>3</sup> 12 CFR 1.3(f). For purposes of this limit, the OCC requires aggregation of ABS issued by obligors that are related directly or indirectly through common control. 12 CFR 1.4(d)(i).

The OCC established this 25 percent limit in 1996. Originally, the OCC proposed an even more restrictive 15 percent limit, but ultimately chose a 25 percent limit with the following explanation:

The OCC believes the 25 percent of capital limit is a prudential limit that provides sufficient protection against undue risk concentrations. This limit parallels the 25 percent credit concentration benchmark in the Comptroller's Handbook for National Bank Examiners. The Handbook identifies credit concentrations in excess of 25 percent

<sup>2</sup> NCUA's corporate credit union rule, however, does permit corporate credit unions to invest in ABS. 12 CFR 704.5(c)(5). The corporate rule generally limits the aggregate of all investments, including ABS, issued by any single obligor to 50 percent of the corporate credit union's capital or \$5 million, whichever is greater. 12 CFR 704.6(c).

<sup>3</sup> The capital and surplus of a national bank is roughly equivalent to the net worth of a natural person credit union. Compare 12 CFR 1.2(a) with 12 CFR 702.2(f) and the definition of the "net worth" in proposed § 701.21(h)(3)(iv).

of a bank's capital as raising potential safety and soundness concerns. For this purpose, the Handbook guidance aggregates direct and indirect obligations of an obligor or issuer and also specifically contemplates application of the 25 percent benchmark to concentrations that may result from an acquisition of a volume of loans from a single source, regardless of the diversity of the individual borrowers.

61 FR 63972, 63977 (Dec. 2, 1996)(emphasis in original).

In comparing indirect, outsourced programs and ABS, the Board notes there are certain protections for the ABS investor that do not exist in the indirect, outsourced loan programs. The creation and sale of ABS securities are regulated by the Securities and Exchange Commission, while the various vendors that currently market indirect, outsourced loan programs to credit unions have no specific regulatory oversight. Further, the only ABS that corporate credit unions and national banks may invest in are reviewed and rated by nationally recognized statistical rating organizations (NRSROs) while the vendors currently offering indirect, outsourced programs to credit unions are often privately held companies with no NRSRO rating.

The proposed rule, with limits of 50 and 100 percent, is less restrictive than the 25 percent that the OCC permits for national bank investment in ABS. While investing is a secondary activity for credit unions, lending is a primary purpose. Credit unions should have maximum flexibility to make loans to members within the bounds of safety and soundness.

The Board is generally not inclined to allow a credit union to place over 100 percent of its net worth at risk. A credit union is not likely to experience a 100 percent devaluation of any particular indirect, outsourced vehicle loan portfolio but substantial devaluations are possible, particularly in portfolios of poor credit quality or in the event of fraud. In addition, inadequate oversight in one credit union program, such as a lending program, may indicate poor due diligence and potential losses in other programs at that credit union. Accordingly, the Board has determined that a credit union should be held to a maximum concentration of 100 percent of net worth unless it can demonstrate a high level of due diligence and controls.

In determining when a credit union may move from the 50 percent limit to the 100 percent limit, the Board examined the average life of the loans that make up an indirect, outsourced program portfolio. Average vehicle loan life depends on various factors. For

example, it can be as little as 20 to 24 months for subprime vehicle loans, and as much as 36 months or more for prime, new vehicle loans. After about 30 months of experience, then, a credit union that is properly monitoring loan performance on vehicle loans should have a sufficient understanding of the historical performance of that portfolio. At the 30-month point, the Board believes that an increase in concentration limits from 50 percent of net worth to 100 percent is appropriate.

Regardless of whether a credit union is at or below its concentration limit, all credit unions should conduct due diligence, both before entering into indirect, outsourced lending programs and on an on-going basis. Even at lesser concentration levels, these programs entail significant risk that can negatively affect net worth. All credit unions involved in these programs must be familiar with relevant regulatory limitations and guidance, including those documents referenced earlier in this preamble.

The proposed rule is limited in scope, in that it is limited to loans made to finance vehicle purchases and the concentration limits do not apply to servicers that are federally-insured depository institutions or wholly-owned subsidiaries of federally-insured depository institutions. The risks to credit unions associated with these servicers are mitigated because federal regulators have access to and oversight of these entities. Of course, credit unions must still conduct appropriate due diligence even when using these servicers.

The proposed concentration limits are not, however, limited to loans of any particular credit quality, such as prime, nonprime, or subprime loans. Still, loan portfolios of lesser credit quality require greater due diligence, as described in the Risk Alert.<sup>4</sup> Also, the due diligence required for a waiver of the concentration limits may increase for portfolios of lesser credit quality.

## 2. Waiver Provision

Section 701.21(h)(2) of the proposed rule establishes a waiver process to permit credit unions with high levels of

due diligence and tight controls to have greater concentration limits. A credit union requesting a waiver of the concentration limits may apply to the regional director who will consider various criteria in determining whether to grant a waiver, including:

- The credit union's understanding of the third party servicer's business model, organization, financial health, and the program risks;
- The credit union's due diligence in monitoring and protecting against program risks;
- The credit union's ability to control the servicer's actions and replace an inadequate servicer as provided by contract;
- Other relevant factors related to safety and soundness considerations.

If a regional director determines that a waiver is appropriate, the regional director will include appropriate limitations on the waiver such as a substitute concentration limit and a waiver expiration date.

## 3. Waiver Criteria

Credit unions that desire greater concentration limits must have high levels of due diligence and tight controls. A discussion of the criteria a regional director will use when reviewing an application for waiver follows.

### a. The Credit Union's Understanding of the Third Party Servicer's Organization, Business Model, Financial Health, and Program Risks

Often, an indirect, outsourced vendor is a privately held company that processes significant cash flows for the credit union and also controls important credit union records, such as the vehicle title documents and current member contact information. A credit union requesting a concentration limit waiver must demonstrate a comprehensive understanding of the third party's organization, business model, financial health, and the risks associated with the vendor's program. The credit union must also demonstrate that the servicer is adequately capitalized to meet its financial obligations.

A credit union requesting a waiver should provide detailed information about the following in its waiver request to the regional director:

- The vendor's organization, including identification of subsidiaries and affiliates involved in the program and the purpose of each;
- The various sources of income to the vendor and the credit union in the program and any potential vendor conflicts with the interests of the credit union;

- The experience, character, and fitness of the vendor's owners and key employees;

- The vendor's ability to fulfill commitments, as evidenced by aggregate financial commitments, capital strength, liquidity, reputation, and operating results;<sup>5</sup>

- How loan-related cash flows, including borrower payments, borrower payoffs, and insurance payments, are tracked and identified in the program;

- The vendor's internal controls to protect against fraud and abuse, as documented by, for example, a current SAS 70 type II report prepared by an independent and well-qualified accounting firm;

- Insurance offered by the vendor, including interrelated insurance products, premiums, conditions for coverage beyond the control of the credit union (e.g., a prohibition on extension of the insured loans past maturity), and limitations such as aggregate loss limits;

- The underwriting criteria provided by the vendor, including an analysis of the expected yield based on historical loan data, and a sensitivity analysis considering the potential effects of a deteriorating economic environment, failure of associated insurance, the possibility of fraud at the servicer, a decline in average portfolio credit quality, and, if applicable, movement in the program back toward industry-wide performance statistics;<sup>6</sup>

- Vendor involvement in the underwriting and processing of loan applications, including use of proprietary scoring or screening models not included in the credit union approved underwriting criteria; and

- The program risks, including (1) credit risk, (2) liquidity risk, (3) transaction risk, (4) compliance risk, (5) strategic risk, (6) interest rate risk, and (7) reputation risk.

Some indirect, outsourced programs have complex business models that include vendor management of the dealer relationship and also insurance provided by the vendor. These business models can produce situations where the vendor's financial interests are not aligned with the credit union's interests. The credit union needs to be aware of

<sup>4</sup> The Board would like to clarify that, potentially, there could be vendor programs affected by this rulemaking that are not affected by the Risk Alert, and vice versa. For example, an indirect, outsourced program that only involves vehicle loans of prime credit quality would be affected by the limits in this proposed rule but not by the Risk Alert. On the other hand, any vendor program that requires the credit union adopt vendor-generated subprime underwriting criteria but does not involve any third-party servicing would be subject to portions of the Risk Alert but not subject to the limits imposed by this proposed rule.

<sup>5</sup> NRSRO ratings, multi-year audited and segmented financials, and explanations of related party transactions and changes to the net worth of the vendor, if any, are also relevant.

<sup>6</sup> If the program loans have historically outperformed industry averages, perhaps because of lower prepayment rates or lower default proportions, the credit union should calculate expected yield should the prepayment rates or default proportions move upwards toward the industry averages.

these situations and, if appropriate, take protective action.

For example, the dealer's interest in an indirect lending situation is to obtain financing so that the dealer can sell a vehicle. The credit union's interest is to ensure that loan applications are properly underwritten, and that only members who are qualified for loans receive loans. With an indirect, outsourced program, the third-party vendor controls information on the quality of all of a particular dealer's originations. A vendor could present loans to a credit union from a changing list of dealers, making it difficult for the credit union to identify and screen out such substandard dealers. This creates a potential for the vendor to permit dealers with substandard underwriting performance to remain active in the program.

Unlike typical indirect lending where the dealer receives an origination fee, in some vendor programs the vendor processes the loan application for the credit union and the vendor also receives significant income from dealer fees. The credit union needs to fully understand the relationship between the vendor and the dealers. Credit unions seeking a concentration limit waiver should review agreements between the vendor and associated dealers.

Some vendors provide third-party default insurance to credit unions, and this presents a potential conflict. This insurance pays most of the loan deficiency balance to the credit union if a loan defaults and a vehicle is repossessed and sold at auction. In the event of high loan default rates, the interests of the credit union and insurance company may conflict. The credit union would like the vehicles repossessed and sold and the insurance paid, while the insurance company would rather not pay the claims if they can be legally avoided. Some vendors align their interests with the insurance company, not the credit union, through guaranty or reinsurance agreements. That is, if the vehicle is repossessed and sold, the insurance company passes some or all of its costs for paying the claim through to the vendor. This creates a potential conflict of interest and an incentive for the vendor, as servicer, not to repossess vehicles. For example, a delay in repossession increases the odds that a vehicle will disappear (i.e., go skip) or a borrower will declare and complete a bankruptcy under chapter 13, and in neither situation will the default insurance pay. In addition, a delay in repossession on a default near loan maturity may also cause the insurance coverage to lapse whether or not the vehicle is ultimately

repossessed. Accordingly, a credit union needs to understand the relationship between the vendor and the insurance company and the associated risks to the credit union. To understand this relationship fully, a credit union desiring a concentration limit waiver should review all agreements between the vendor, affiliates of the vendor, and the associated insurance companies.

Another potential conflict exists where the vendor controls the dealer relationship and can route a potential loan to multiple funding sources. For example, some vendors track statistics on loan performance by dealership. A credit union should be aware if a vendor then routes loan applications from the preferred dealerships to the preferred funding sources. A credit union desiring a waiver should understand the various funding sources available to the vendor and document how the vendor tracks vendor performance and makes funding decisions.

#### b. The Credit Union's Due Diligence in Monitoring and Protecting Against Program Risks

Credit unions must design a due diligence program that identifies and assesses all material risks. The nature and extent of the due diligence required for a waiver depends on the nature and extent of the identified risks. Higher concentration levels entail more risk to the net worth of the credit union, and so the requisite due diligence also depends on the substitute concentration limit that the credit union requests.

#### c. Whether Contracts Between the Credit Union and the Third-Party Servicer Grant the Credit Union Sufficient Control Over the Servicer's Actions and Provide for Replacing an Inadequate Servicer

After a loan is funded, the most important activity affecting loan performance is the quality of the servicing. As NCUA stated in LTCU No. 04-CU-13, and, again, in the Risk Alert, safety and soundness requires a credit union to limit the power of a third-party servicer to alter loan terms. Also, the servicing contract must contain a mechanism, or exit clause, to replace an unsatisfactory servicer.

To qualify for a waiver of these regulatory concentration limits, the servicing agreement should include more than minimal protections for the credit union. Servicer performance standards should be objective and clear, and the waiver request should clearly articulate how the performance standards protect the interests of the credit union. The exit clause, including any cure period, should be exercisable

in a reasonable period of time. The more intensive the requisite servicing, such as for nonprime or subprime loans, the shorter that period of time should be. A credit union's right to exit the servicing agreement should be exercisable at a reasonable cost to the credit union. If the credit union must pay a punitive fee to replace a poor servicer, or give up valuable insurance protection or legal rights without adequate compensation, the servicing agreement will not satisfy this waiver criterion.

The regional director may also consider any legal reviews obtained by the credit union on these contracts. The regional director should consider the scope and depth of the review and the qualifications of the reviewer.

#### d. Other Factors Related to Safety and Soundness

Regional directors may consider other relevant factors when determining whether to grant a waiver of the concentration limits as well as the size of any substitute limit. Other factors include, but are not limited to, the demonstrated strength of the credit union's management and the credit union's previous history in exercising due diligence over similar programs.

#### 4. Grandfathering

Several credit unions that currently participate in indirect, outsourced programs have concentration levels that exceed the proposed concentration limits. For those credit unions that exceed the concentration limits on the effective date of any final rule, the rule will not require any divestiture. The rule will prohibit these credit unions from purchasing any additional loans, or interests in loans, from the affected vendor program until such time as the credit union either reduces its holdings below the appropriate concentration limit or the credit union obtains a waiver to permit a greater concentration limit.

The Board is concerned that some credit unions may consider making large purchases of loans that would be subject to the rule before the effective date of a final rule. NCUA will review any large purchases closely and credit unions should be advised that NCUA may consider appropriate supervisory action, including divestiture, to ensure that the credit union's actions were safe and sound.

#### Regulatory Procedures

##### *Regulatory Flexibility Act*

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic

impact a proposed rule may have on a substantial number of small credit unions (those under \$10 million in assets). This proposed rule establishes for federally-insured credit unions a concentration limit on indirect vehicle loans serviced by third parties. As of May 31, 2005, NCUA estimates no more than five small credit unions were involved in purchasing vehicle loans, or interests in loans, from an indirect, outsourced vendor program. The proposed rule, therefore, will not have a significant economic impact on a substantial number of small credit unions and a regulatory flexibility analysis is not required.

#### *Paperwork Reduction Act*

The waiver provision of section 701.21(h)(2) contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), NCUA has submitted a copy of this proposed rule as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval of a new Collection of Information, Third-Party Servicing of Indirect Vehicle Loans.

The proposed § 701.21(h)(2) requires that credit unions requesting a waiver provide sufficient information to NCUA to determine if a waiver is appropriate. NCUA is not certain how many credit unions may request a waiver. Currently, there are approximately twenty credit unions that have in excess of 100 percent of net worth invested in indirect, outsourced vehicle loan programs. NCUA believes that no more than ten of these credit unions will request a waiver during the first year. Also, during the first year, NCUA estimates that no more than five additional credit unions will approach their concentration limits and also request a waiver. It will take a credit union approximately fifty hours to prepare the waiver request, including preparing a description of current and planned due diligence efforts and making copies of all supporting documentation. Fifteen respondents times fifty hours each is a total annual burden of seven hundred and fifty hours.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Attn: Mark Menchik, Room 10226, New Executive Office Building, Washington, DC 20503.

The NCUA considers comments by the public on this proposed collection of information in—

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the NCUA, including whether the information will have a practical use;
- Evaluating the accuracy of the NCUA's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

The Paperwork Reduction Act requires OMB to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA on the proposed regulations.

#### *Executive Order 13132*

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

#### *The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families*

NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105-277, 112 Stat. 2681 (1998).

#### **List of Subjects**

##### *12 CFR part 701*

Credit unions, Loans.

##### *12 CFR part 741*

Credit unions, Requirements for insurance.

By the National Credit Union Administration Board on December 15, 2005.

**Mary Rupp,**

*Secretary of the Board.*

For the reasons stated in the preamble, the National Credit Union Administration proposes to amend 12 CFR parts 701 and 741 as set forth below:

#### **PART 701—ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS**

1. The authority citation for part 701 continues to read as follows:

**Authority:** 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 *et seq.*; 42 U.S.C. 1981 and 3601-3619. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. In part 701, add a new paragraph (h) to § 701.21 to read as follows:

##### **§ 701.21 Loans to Members and Lines of Credit to Members.**

\* \* \* \* \*

(h) Third-Party Servicing of Indirect Vehicle Loans.

(1) A federally-insured credit union must not acquire any vehicle loan, or any interest in a vehicle loan, serviced by a third-party servicer if the aggregate amount of vehicle loans and interests in vehicle loans serviced by that third-party servicer and its affiliates would exceed:

(i) 50 percent of the credit union's net worth during the initial thirty months of that third-party servicing relationship; or

(ii) 100 percent of the credit union's net worth after the initial thirty months of that third-party servicing relationship.

(2) Regional directors may grant a waiver of the limits in paragraph (h)(1) of this section to permit greater limits upon written application by a credit union. In determining whether to grant or deny a waiver, a regional director will consider:

(i) The credit union's understanding of the third party servicer's organization, business model, financial health, and the related program risks;

(ii) The credit union's due diligence in monitoring and protecting against program risks;

(iii) Whether contracts between the credit union and the third-party servicer grant the credit union sufficient control over the servicer's actions and provide for replacing an inadequate servicer; and

(iv) Other factors relevant to safety and soundness.

(3) For purposes of paragraph (h) of this section:

(i) The term "third-party servicer" means any entity, other than a federally-insured depository institution or a wholly-owned subsidiary of a federally-insured depository institution, that receives any scheduled periodic payments from a borrower pursuant to the terms of a loan and distributes the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan.

(ii) The term "its affiliates," as it relates to the third-party servicer, means any entities that:

(A) Control, are controlled by, or are under common control with, that third-party servicer; or

(B) Are under contract with that third-party servicer or other entity described in paragraph (h)(3)(ii)(A) of this section.

(iii) The term "vehicle loan" means any installment vehicle sales contract or its equivalent that the credit union must report as an asset under generally accepted accounting principles. The term does not include loans made directly by the credit union to a member.

(iv) The term "net worth" means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles. For low income-designated credit unions, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders, and the National Credit Union Share Insurance Fund.

\* \* \* \* \*

## PART 741—REQUIREMENTS FOR INSURANCE

3. The authority citation for part 741 continues to read as follows:

**Authority:** 12 U.S.C. 1757, 1766, 1781–1790, and 1790d. Section 741.4 is also authorized by 31 U.S.C. 3717.

4. Add a new paragraph (c) to § 741.203 to read as follows:

### § 741.203 Minimum loan policy requirements.

\* \* \* \* \*

(c) Adhere to the requirements stated in § 701.21(h) of this chapter concerning

third-party servicing of indirect vehicle loans. Before a state-chartered credit union applies to a regional director for a waiver under § 701.21(h)(2) it must first notify its state supervisory authority. The regional director will not grant a waiver unless the appropriate state official concurs in the waiver.

[FR Doc. E5–7584 Filed 12–20–05; 8:45 am]

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG–144615–02]

RIN 1545–BB26

### Section 482: Methods To Determine Taxable Income in Connection With a Cost Sharing Arrangement; Correction

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Correction to notice of proposed rulemaking.

**SUMMARY:** This document corrects notice of proposed rulemaking (REG–144615–02) that was published in the **Federal Register** on Monday, August 29, 2005 (70 FR 51116). The document contains proposed regulations that provide guidance regarding methods under section 482 to determine taxable income in connection with a cost sharing arrangement.

**FOR FURTHER INFORMATION CONTACT:** Jeffrey L. Parry or Christopher J. Bello, (202) 435–5265 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

The notice of proposed rulemaking (REG–144615–02) that is the subject of this correction is under section 482 of the Internal Revenue Code.

##### Need for Correction

As published, REG–144615–02 contains errors that may prove to be misleading and are in need of clarification.

##### Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–144615–02), that was the subject of FR Doc. 05–16626, is corrected as follows:

1. On page 51116, column 2, in the preamble, under the paragraph heading "Paperwork Reduction Act", eighth paragraph, third line, the language "of information (see below);" is corrected to read "of information (see above);".

2. On page 51116, column 3, in the preamble, under the paragraph heading "Background", tenth line from the bottom of the last paragraph, the language "for this type of external contributions is" is corrected to read "for this type of external contribution is".

3. On page 51117, column 1, in the preamble, under the paragraph heading "A. Overview", fourth line from the bottom of the first paragraph, the language "the commensurate income standard" is corrected to read "the commensurate with income standard".

4. On page 51117, column 2, in the preamble, under the paragraph heading "A. Overview", the second line from the bottom of the column, the language "appropriate return would be provided to such" is corrected to read "appropriate return would be required to such".

5. On page 51118, column 2, in the preamble, under the paragraph heading "1. General Rule—Proposed § 1.482–7(a)", the last line of the second paragraph, the language "exploiting cost shared intangibles." is corrected to read "exploiting the cost shared intangibles.".

6. On page 51118, column 3, in the preamble, under the paragraph heading "1. General Rule Proposed § 1.482–7(a)", the second line from the bottom of the first full paragraph of the column, the language "the rules of §§ 1.482–1 and 1.482–5" is corrected to read "the rules of §§ 1.482–1 and 1.482–4".

7. On page 51118, column 3, in the preamble, under the paragraph heading "a. CSA Transactions in General", the eighth line of the first paragraph, the language "circumstances. (Emphasis added.)" is corrected to read "circumstances \* \* \* (Emphasis added.)".

8. On page 51119, column 1, in the preamble, under the paragraph heading "a. CSA Transactions in General", the fifteenth line of the first paragraph of the column, the language "expected in a cost sharing agreement" is corrected to read "expected in a cost sharing arrangement.".

9. On page 51119, column 1, in the preamble, under the paragraph heading "a. CSA Transactions in General", the second line from bottom of the second full paragraph, the language "be provided to such party to reflect its" is corrected to read "be required to such party to reflect its".

10. On page 51124, column 3, in the preamble, under the paragraph heading "h. Valuation Consistent With the Investor Model—Proposed § 1.482–7(g)(2)(viii)", the third line from the bottom of the column, the language