



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

LS/HMU:cch

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7/29/85

Mr. John Sheehy
Executive Vice President
Colorado Credit Union League
P.O. Box 1227
Arvada, CO 80001

Dear John:

This is in response to your letter of July 9, 1985, concerning Federal credit union (FCU) use of their credit union service organization (CUSO) authority to participate in a limited partnership agreement in connection with National Warranty Corporation's vehicle service contract program (program).

National Warranty Corporation has been in contact with us concerning the permissibility of FCU's participating in the program directly and the permissibility of FCU's participating through their CUSO's. As you know, we have previously stated that the program is impermissible for direct FCU participation. We explained our position in a letter dated February 19, 1985, to Charles W. MacDonald (former counsel to National Warranty Corporation), a copy of which is enclosed. As to participation through a CUSO, it is at best unclear whether NCUA's present CUSO regulation permits such an activity. This issue, among other CUSO issues, should be cleared up as a result of the revisions to the CUSO regulation that are now being drafted. During the process of NCUA's review of the regulation, NCUA has adopted the policy that activities such as this (i.e., ones that are not clearly permitted by the present rule, or so-called "grey area" activities) should not be engaged in by FCU's through their CUSO's, except in cases where a particular FCU and CUSO began their activity prior to January 25, 1985 (the date of announcement of the policy). This position is further explained in our May 21, 1985, letter to Nicholas Campasano, a copy of which is also enclosed.

I hope we have been of assistance. If you have further questions, please let me know.

Sincerely,

ROBERT M. FENNER
Acting General Counsel

Enclosures

FOIA file: Vol. III, B, 2, a. CUSO



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4675

February 19, 1985

Charles W. MacDonald, Esquire
P.O. Box 1088
Wheat Ridge, CO 80033

Dear Mr. MacDonald:

This is in response to your letter of January 9, 1985, concerning Federal credit union (FCU) participation in National Warranty Corporation's (NWC) vehicle service contract program (program).

We raised three problems with FCU involvement in NWC's program in our letter to you of December 20, 1984. Each of these problems is discussed in your response to us. Our first area of concern was the contractual liability FCU's are taking on by entering into the vehicle service contracts with their members. You explain that, while credit unions are potentially contractually liable to their members, they are protected from actual liability by both NWC and the insurance company backing NWC. You enclosed a balance sheet for Automobile Warranty Corporation (NWC's parent corporation) to show its financial strength. Although it may be unlikely that both NWC and its insurance company will become insolvent or otherwise default on their obligations, that possibility exists with NWC's program or any similar program. Also, other problems short of default by NWC may arise. For example, the credit union may pay claims that NWC will not subsequently agree to honor. The operative consideration is that the credit union is directly and primarily liable under the warranty contract. Federal credit unions are, like other federally chartered financial institutions, organizations of limited statutory powers. It is questionable whether those powers include the authority to undertake the role of a warrantor of motor vehicles. Moreover, while it is always possible in programs such as this for the credit unions, through insurance or other contractual arrangements, to place a third party in a position of responsibility to reimburse the credit union, it is neither possible nor desirable for NCUA to attempt to monitor the reliability of such third parties. It is for these reasons that the regulations prohibit FCU's from assuming the role of vendor, and instead limit them to performing administrative or intermediary type functions. Our primary concern lies with the safety and soundness of credit unions and ultimately with the National Credit Union Share Insurance Fund. We maintain our previous position that FCU's do not have the authority to enter into the vehicle service contracts. FCU's are exceeding the bounds of Section 721.1 of the NCUA Regulations by entering into the contracts.



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Our second area of concern was the percentage reimbursements FCU's are receiving from NWC. As you know, FCU's are limited to cost reimbursement by Section 721.2 of the Regulations. If an FCU can document that its costs equal the percentage reimbursement it is receiving, the percentage reimbursement would be within the bounds of the Regulation.

Our third concern was that the program could be in violation of state insurance laws which do not permit financial institutions to enter into vehicle service contracts. As noted in your letter, your research indicates that the program could be a problem in twelve states. You state that NWC will either offer a mechanical breakdown insurance program or not market its product at all in these twelve states. Prospectively, that is an acceptable solution to our third concern. Your letter does not address the question of whether the program has previously been marketed through credit unions in those states, which of course would have placed the credit unions in direct violation of the state insurance laws. If that has been the case, we trust that NWC will take steps to indemnify the credit unions in the event of any possible fines or other liability that might arise.

In summary, FCU's may not enter into the vehicle service contracts with their members. The program, as it is presently structured, is impermissible for FCU's under Part 721 of the Regulations. A mechanical breakdown insurance plan where an insurance policy is issued to the FCU member is an acceptable program for FCU's. FCU's would continue to be subject to the reimbursement restrictions for administrative functions performed for third party vendors pursuant to Part 721 in a mechanical breakdown insurance plan.

We hope that we have been of assistance.

Sincerely,

ROBERT M. FENNER
Director, Department of Legal Services

cc: Roger Barnard, NAFCU



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

LS/HMU:cch
4693
May 21, 1985

Nicholas Vincent Campasano, Esquire
1405 Deer Park Avenue
North Babylon, NY 11703

Dear Mr. Campasano:

This is in response to your letter of March 5, 1985, concerning the permissibility of a credit union service organization (CUSO) entering into National Warranty Corporation's Vehicle Service Contract Program (Program).

As noted in your letter, it is the opinion of this Office that the Program is impermissible for FCU's to enter directly. A copy of our letter of February 19, 1985, to National Warranty Corporation is enclosed. We believe that the Program is not clearly permissible for CUSO's. The current CUSO regulation (12 C.F.R. Section 701.27) sets out five categories of activities which a CUSO may provide. The five categories are as follows: (1) operational functions; (2) family financial services; (3) acting as an insurance agent; (4) personal property leasing; and (5) other services, as determined by the NCUA Board, that are associated with routine credit union operations. (See 12 C.F.R. §701.27(b)(1)-(5).) The Program does not clearly fit into the first four categories. Neither National Warranty Corporation nor any FCU has presented an argument to us that the Program fits within any of the first four categories. The Program has not been presented to the Board for approval under the fifth category. It should be noted that National Warranty Corporation did not present the Program as a CUSO activity, but only as one offered by an FCU directly.

As you may know, the Board, on January 25, 1985, proposed and requested comment on changes to its CUSO regulation (see 50 Federal Register 4698, 2/1/85). It is anticipated that a new rule will be issued within the next several months. Until that time, the NCUA has adopted an informal policy that CUSO's that were offering the Program prior to January 25, 1985, may



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maintain their status quo. A change in the regulation could result in changes affecting existing CUSO activities.

We hope that we have been of assistance.

Sincerely,

A handwritten signature in cursive script that reads "Robert M. Fenner".

ROBERT M. FENNER
Director, Department of Legal Services

Enclosure

cc: Charles MacDonald
Roger Barnard, NAFCU