NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

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Office of General Counsel

Mr. John P. Patterson
Chairman, Board of Directors
National Institutes of Health Federal Credit Union
9000 Rockville Pike
Building 31, Room 1A08
Bethesda MD 20892

Dear Mr. Patterson:

This is in response to your letter of August 22, 1986, concerning the legality of a Federal credit union (FCU) loan to three individuals, two of whom are members of your FCU and a third who is not.

With exceptions not relevant here, Section 107(5) of the FCU Act, 12 U.S.C. §1757(5), only authorizes an FCU to make loans to its members. While some nonmember participation in member loans is permissible, the issue raised in your letter is at what point does nonmember involvement in a loan to a member so substantially distort the direct lending relationship between the FCU and the member as to render the transaction an impermissible loan to a nonmember in violation of Section 107(5) of the Act.

The easy case is where the nonmember receives total use and benefit of the proceeds of the loan to the member and is primarily responsible for the loan repayment. We have previously stated that, where the nominal member borrower acts purely as a conduit, funnelling the loan proceeds to a third party nonmember while receiving little or no benefit from the loan for himself, the loan is illegal. We consider this to be a strawman or sham transaction. The nonmember is the actual recipient of the loan and the loan would be in violation of Section 107(5) of the FCU Act.

At the other end of the spectrum is the situation where the nonmember is a comaker on a loan to a member with the nonmember's involvement limited to guaranteeing payment as a secondary party or accommodation party (e.g., guarantor). This type of loan transaction would not violate Section 107(5) of the FCU Act. Further, a nonmember may pledge his/her collateral to secure a loan to a member and, provided he/she receives no use or benefit of the loan, would not violate the FCU Act.

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The difficult situations arise in mid-range between these two extremes. Pontential loans involving nonmembers should be analyzed on a case-by-case basis to determine their permissibility. Some of the elements to be included in such analysis is the loan size vis-a-vis the ability of the member to repay, whether the nonmember pledged collateral, which party has primary liability for repayment, and who has the use and benefit of the proceeds. How the nonmember is characterized in the loan transaction (eg., as cosigner, comaker or guarantor) is not, in and of itself, a determining factor. One must analyze all of the elements of each loan transaction and determine whether or not it is permissible under Section 107(5) of the FCU Act.

I hope that we have been of assistance. Please let me know if you have any further questions.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

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