NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

April 13, 1987

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Office of General Counsel

Alex Koseluk, Esq.
General Counsel
Nebraska Credit Union League & Affiliates
NCUL Building
4315 Frances Street
Omaha, NE 68105

Dear Mr. Koseluk:

This is in response to your recent letter to Chairman Jepsen concerning interest refunds on Federal credit union ("FCU") loans. Specifically, you stated that a Nebraska FCU is proposing to declare a 7% interest rate refund on interest paid from January 1, 1987, through September 1, 1987, on all loans made during that period. You have asked for our thoughts on this matter.

As you know, Section 701.24 of the NCUA Rules and Regulations (12 C.F.R. §701.24) addresses interest refunds made by FCU's. The authority for FCU's to make interest refunds is found in Section 113(9) of the FCU Act (12 U.S.C. §1761b(9)) and states as follows:

> "The board of directors shall-
>
> (9) authorize interest refunds to members of record at the close of business on the last day of any dividend period from income earned and received in proportion to the interest paid by them during that dividend period."
> (Emphasis added.)

It is clear from Section 113(9) that an FCU's board of directors can only authorize interest refunds to members of record at the close of business on the last day of a particular dividend period and that such refunds can only be authorized if there is income earned and received. Hence, if there are insufficient earnings available, an interest refund cannot be paid.

Further, Section 116 of the FCU Act (12 U.S.C. §116) and Part 702 of the NCUA Rules and Regulations (12 C.F.R. §702) require that an FCU set aside certain reserves from its gross income. The reserve transfer must be made prior to a dividend payment or interest refund.

Lastly, Section 701.24 of the NCUA Rules and Regulations places additional restrictions on interest refunds. Section 701.24(f) states that an interest refund cannot be authorized for any dividend period unless dividends have been declared and paid on share accounts. You should also recognize that there are contractual obligations incurred by an FCU with respect to the specified dividend rate on its share certificates. Earnings available for these purposes cannot be disbursed as interest refunds if that would result in the failure to pay the dividends specified in the FCU's share certificates.

If the FCU wishes to use interest refunds as a marketing tool for auto loans, one possible solution is to have the FCU express its intent that if there are available earnings after providing for reserves, expenses, and dividends, a percentage of the remaining earnings will be refunded. The FCU would need to take care in fully and clearly disclosing this to its members so that they are not misled.

I hope that we have been of assistance.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

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