



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

May 29, 1987

GC/HML:sg
4650

Office of General Counsel

John P. Lowry, Esq.
Mechley, Robbins & Kelly Co., L.P.A.
Second National Building
832 Main Street
Cincinnati, OH 45202-2123

Dear Mr. Lowry:

This is in response to your letter concerning your Federal credit union ("FCU") making loan payments from member share accounts for various loan obligations. The loans have not been made by the FCU, but rather were made by third-party lenders.

The situation you describe is as follows. FCU members have their pay deposited directly into share and/or share draft accounts at the FCU. Members have also authorized the FCU to make loan payments from their accounts to various third-party creditors. Members are making withdrawals (via automatic teller machines) which reduce their account balances below the amounts of loan payments due. Hence, full payment of loan installments cannot be made to third-party lenders by the FCU. You ask whether the FCU has the authority to subtract the loan payment from the member's account balance before the loan payment is actually due.

As you know, an FCU may make payments to third parties from member's accounts upon written authorization from the member. (See Section 5210 of the Accounting Manual for FCU's, enclosed.) The authority to make such payments is incidental to an FCU's authority to accept payment on shares. (See Sections 107(6) and (16) of the FCU Act, 12 U.S.C. 1757(6) and (16).) If the FCU wishes to change the terms of the authorization from the member (e.g., deduct payment from member's account earlier than is presently authorized), a change in the initial authorization would likely be required under state contract law. Since a copy of the member's authorization was not enclosed and any change in the authorization would be a matter of state contract law, we cannot give you definitive advice on this issue.

FOIA

Vol. II, A

Incidental, 3rd Party
Payments

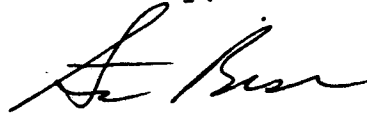
John P. Lowry, Esq.

Page Two

Aside from the authorization issue, an early deduction in the member's account may cause other problems. For instance will funds be immediately remitted to the creditors? If not, who keeps the funds in the interim? The insurability of the funds in the interim by the National Credit Union Share Insurance Fund may be affected. (See Section 745.3(a)(3) of NCUA Regulations (12 C.F.R. 745.3(a)(3)), enclosed.) If specific questions concerning the NCUA Regulations arise, do not hesitate to contact us.

I hope that we have been of assistance.

Sincerely,



STEVEN R. BISKER
Assistant General Counsel

HMU:sg

Enclosure

5210 THIRD PARTY PAYMENTS

The National Credit Union Administration has determined that Federal credit unions may receive payments from or make payments to third parties upon written authorization being established by the member in advance of the completion of the payment transfer. These receipts and payments may be by electronic funds transfer (EFT) or by use of conventional checks, drafts, money orders, etc. Some examples of third party payment arrangements are:

1. Preauthorized payments to a member's share or loan account from the member's employer (Payroll Deduction Plan).
2. Direct deposit of Federal Recurring Payments, such as Social Security, Civil Service annuities, and Railroad, Veteran's Administration, Army, Navy and Air Force retirement checks.
3. Check transmittal services in which credit unions accept members' paychecks for transactions with the credit union, then sends a check for the remainder of the paycheck to the member's bank for deposit to his account.
4. Payment of member's utility bills from members' share accounts.
5. Preauthorized payment plans from the members' share accounts to pay other recurring items such as insurance premiums and mortgages or rent payments.

5210.1 ELECTRONIC FUNDS TRANSFER, AUTOMATED CLEARING HOUSE PAYMENTS, AND TELEPHONE BILL PAYMENTS

Credit union members may instruct employers and others making regular payments to them to have funds deposited directly into their accounts. This service may be used for depositing wages, social security benefits, dividends, and other types of income payments. In a direct deposit arrangement, the originator of the payment (employer, etc.) directs its financial institutions to transfer funds electronically, through an automated clearing house, (a computer used to sort transactions and forward them to the appropriate receiving financial

institution) to the financial institution designated in a preauthorized agreement by the person receiving the payment. Upon receipt of the electronic advice of credit, the credit union deposits funds in the appropriate member's account.

Two types of electronic fund transfer services may be used by a credit union member to pay bills. First, the member may preauthorize merchants and creditors to draw funds from his or her account. Under this arrangement the member would direct in writing a merchant or other party to draw funds from his or her account on a given date in an amount sufficient to pay the bill. This arrangement is normally used only for recurring bills of a fixed amount such as insurance premiums, mortgage payments or rent. Secondly, the member by written agreement may direct the credit union to pay bills. Under this arrangement, the member usually receives an identification code from the credit union. This code is used when requesting the credit union to charge the member's account in order to pay a bill. Normally a written agreement is completed only once and from that point on the instructions to pay the bill are given verbally over a telephone or through the use of a touch-tone telephone using a prearranged coding scheme.

5210.1.2 ELECTRONIC FUNDS TRANSFER ACT

The Electronic Funds Transfer Act provides a basic framework establishing the rights, liabilities and responsibilities of participants in electronic funds transfer systems. The Act has civil and criminal liabilities for violations of its provisions.

An Electronic Funds Transfer (EFT) is a transfer of funds initiated through an electrical terminal, telephone or computer that instructs a financial institution to either credit or debit an asset account. For this purpose, an asset account is a share account, share draft account, and/or share certificate account established by the consumer primarily for personal or household use.

Examples of covered transactions are:

1. Electronic terminals — Any transaction affecting a share account completed through an electronic terminal is a covered transaction. An electronic terminal is a machine, usually activated by a plastic card and/or code, which allows consumers to

transact routine business, i.e. deposits or withdrawals to or from any share account.

2. Direct deposits — All common forms of credits to a consumer's account, such as payroll, payroll deduction, military allotments and other Federal recurring payments, such as social security, VA benefits, military payroll, etc., are covered *if settled electronically*.
3. Preauthorized payments — Any debit or credit affecting a consumer's account on a regularly recurring basis such as insurance or loan payments, bill payments, and dividend and annuity payments, are covered *if settled electronically*.

(Electronically initiated settlement — If settlement occurs without a paper check, it is a covered transaction. Settlement means the actual cash transfer to or from the credit union's bank account for debit or credit to a member's share account. Electronic settlement occurs when the cash transfer to or from your credit union's bank account is via an electronic message instead of a paper check.)

It has been determined that there are electric funds transfers which are exempted from Regulation E. These exemptions are listed below. At the present time, this list is not all-inclusive.

1. Check guarantee or authorization services that do not directly result in a debit or credit to the consumer's account;
2. Wire transfers (The Fedwire, bankwire, and similar transfer networks are used primarily for business purposes. While they are fully electronic, they are exempt from Regulation E since their primary purpose is to carry non-consumer transactions. Automated Clearing House (ACH) transactions are not exempt, however, when settled electronically, because these transactions affect consumer asset accounts.);
3. Transactions from the credit union into a consumer's account, such as the crediting of dividends to a share account. (However, the credit union is subject to the provisions of the Act covering civil and criminal liability and the compulsory use of EFTs.);
4. Transactions from a consumer's account to the credit union, such as a loan payment. (However, the credit union is subject to the provisions of the Act covering civil and

criminal liability and the compulsory use of EFTs.);

5. Any transfer of funds initiated by a telephone conversation that is not pursuant to a prearranged plan and in which periodic and recurring transfers are not contemplated; and
6. Any transfer between an individual's own account, such as a transfer from a share to a share draft account.

Credit unions that have transfers which are EFTs must comply with the requirements of Regulation E which deals with:

1. Disclosures to members concerning the terms and conditions;
2. Control over issuance of access devices;
3. Frequency of periodic statements and required information included on the statement;
4. Documentation of transfers initiated at an electronic terminal;
5. Procedures for handling preauthorized transfers;
6. Procedures for resolution of errors; and
7. Liabilities for unauthorized use.

5210.1.3 AUTOMATED CLEARING HOUSE

Because of the ever-increasing number of checks that are physically passed through the bank clearing houses, the Automated Clearing House (ACH) was established. The purpose of the ACH is to eliminate the unnecessary handling and rehandling of every check.

Credit unions can become members of an Automated Clearing House so that it will be able to receive direct deposit of Federal recurring payments such as members social security checks or payroll check of Federal employees. Instead of having the U. S. Government prepare checks for each individual, a magnetic tape is prepared and sent to the ACH. The ACH then sorts the tape and credits the financial institution's account for the funds.

All other programs involving the use of an Automated Clearing House's facilities by a Federal credit union must be approved by National Credit Union Administration.

5210.2 FEDERAL RECURRING PAYMENTS

Federal credit unions are encouraged to participate in the Federal Recurring Payments Direct Deposit Program. All financial institutions in the United States have been provided with copies of "The Green Book" prepared by the Department of the Treasury. This publication covers all Federally Recurring Payments and provides information on all aspects of the Direct Deposit Program. Additional copies of the publication can be obtained from:

U. S. Department of the Treasury
Operation Planning and Research Staff
Room 226, Treasury Annex No. 1
Pennsylvania Avenue and Madison Place,
N. W.
Washington, D. C. 20226

Federal credit unions participating in the Federal Recurring Payments Direct Deposit Programs have the option of crediting members' accounts on the due dates of the Federal payments regardless of actual receipt of funds under this program.

5210.3 CHECK TRANSMITTAL SERVICE

A Federal credit union desiring to do so may provide a check transmittal service to its members. Under this system, members present their paychecks for transactions with the credit union. After deducting the amount of the transaction from the amount of the check presented, the credit union sends a check for the remainder of the member's paycheck amount to the member's bank for deposit to his account. This plan may be especially helpful in reducing the amount of cash that a credit union must have on hand for members' payday activities.

When a member presents his paycheck for a transaction, the credit union records his Share, Loan and Interest transactions on a Cash Received Voucher in the normal manner. The total cash received to be shown on the voucher will be the total amount of the check which the member presents. The difference between the amount of the credit union transactions and the total amount of the check will be entered on a blank line on the Cash Received Voucher and identified as "Accounts Payable—Check Transmittal Service" as a credit. The corresponding debit for cash disbursed to the members' banks will be to Accounts Payable — Check Transmittal Service, thereby closing out the balance in that account. The name of the member's

bank and his checking account number will also be shown on a Cash Received voucher. The standard Cash Received Voucher will be used, or a special voucher may be designed to record this type of transaction.

Any checks received under this system are deposited in the credit union's checking account with the other receipts of the day. In summarizing the day's cash receipts, it will be necessary to determine the amount of funds which are to be sent to each bank for credit to the members' accounts. This information must appear on the Summary Cash Received Voucher or on a separate listing which will be attached to the voucher.

In order that the members receive prompt credit to their checking accounts, the credit union will forward its check(s) to the bank(s) on the same day it receives the funds, or as promptly as possible thereafter. If two or more members designate the same bank, the credit union may issue one check for the total amount to be sent to that bank. The credit union's check must be accompanied by a transmittal sheet, identifying the members, their bank account numbers and the amount to be credited to each member's accounts. The wording of the transmittal must indicate that the credit union is carrying out the transactions of the member and, in doing so, incurs no liability to the bank. A copy of each transmittal must be retained in the credit union office.

5210.3.1 ILLUSTRATIVE ENTRIES (JOURNAL AND CASH RECORD)

- (1) Member presents his paycheck for loan payment to the credit union, with the remainder to be transmitted to his checking account.

Dr. — Cash (Acct. No. 731) \$300.00
Cr. — Loans (Acct. No. 701)..... \$45.00
Cr. — Interest on Loans
(Acct. No. 111)..... \$5.00
Cr. — Accounts Payable
(Acct. No. 801)..... \$250.00

- (2) Credit union sends its check to forward remainder of member's paycheck to member's bank checking account.

Dr. — Accounts Payable
(Acct. No. 801)..... \$250.00
Cr. — Cash (Acct. No. 731)..... \$250.00

5210.4 COLLECTION OF UTILITY BILLS BY FEDERAL CREDIT UNIONS

A Federal credit union may make utility bill collection service available to its members. It may also receive a fee from the utility company for extending the service providing the fee is limited to the direct and indirect costs incurred.

5210.4.1 WRITTEN AGREEMENT

A written agreement must be executed between the credit union and the utility company in which the responsibilities and liabilities of the credit union are fully explained. The credit union must have its attorney's written assurance that the agreement conforms with pertinent state or local laws, with the Federal Credit Union Act, bylaws and regulations and that the interests of the credit union are adequately protected.

5210.4.2 PROCEDURES FOR THE COLLECTION OF UTILITY BILLS

5210.4.2.1 RECEIPTS

- (a) A member paying his utility bill must be given a receipt for his payments. This may be either the utility bill stub stamped "paid" or a special receipt (depending on company policy) and/or a cash received voucher.
- (b) Utility bill receipts may be kept in the same drawer with regular receipts unless the credit union desires to separate the proceeds.
- (c) At the end of the day, or more frequently if that is the credit union's custom, the proceeds will be accounted for and reconciled with the portions of the utility bills to be forwarded to the utility company and with the credit union's record of the transactions (vouchers or log).
- (d) It is intended that all utility bill payments from members be entered on the credit union's books. Therefore, members' payments must be made by cash or by check made payable to the credit union. However, it would be permissible for the credit union to accept checks made payable to the utility company if the checks were stamped with a special endorsement so they could be deposited with the credit union's checking account. This arrangement must have the written approval of the utility company.

5210.4.2.2 RECORDS

The credit union must have its own record of the transaction. This will be a cash received voucher. If this method is used, a duplicate voucher form could be used, one copy of which will be given to the member as explained previously. Another method would be to record utility bill receipts in a daily log designed for the purpose or, if appropriate, a form provided by the utility company.

5210.4.2.3 ACCOUNTING INSTRUCTIONS

All receipts and disbursements must be handled through Cash (Account No. 731). The credit union's liability for the funds received will be recorded in Accounts Payable (Account No. 801). Reimbursed fees received from the utility company will be recorded in Miscellaneous Operating Income (Account No. 151).

5210.4.2.4 ILLUSTRATIVE ENTRIES (JOURNAL AND CASH RECORD)

- (1) When the credit union's utility bill collections are accounted for at the end of the day (or more frequently if that is the credit union's custom).

Dr. — Cash (Acct. No. 731) \$500.00
Cr. — Accounts Payable
(Acct. No. 801)
(Name of Utility) \$500.00

- (2) When the utility bill collections are remitted to the utility company.

Dr. — Accounts Payable
(Acct. No. 801) \$500.00
Cr. — Cash (Acct. No. 731) \$500.00

- (3) When the credit union receives the reimbursement fees from the utility company.

Dr. — Cash (Acct. No. 731) \$5.00
Cr. — Miscellaneous Operating
Income (Acct. No. 151) \$5.00

- (4) When the credit union deducts the fees from the utility bill remittances.

Dr. — Accounts Payable (Name of
Utility (Acct. No. 801) \$500.00
Cr. — Cash (Acct. No. 731) \$495.00
Cr. — Miscellaneous Operating
Utility (Acct. No. 151) \$5.00

- (5) Payment of Utility Bills by Share Withdrawal.

A member may authorize his credit union to pay his utility bills by share withdrawal. The Journal and Cash Record entry should be:

Dr. — Shares (Acct. No. 901)\$10.00
Cr. — Accounts Payable
(Acct. No. 801)..... \$10.00

5210.5 OPERATIONAL GUIDELINES

The following guidelines will be observed for all preauthorized payment transfer plans:

- (a) The service will be available to all members.
- (b) The authorization form signed by the member will state that the Federal credit union will not be responsible or liable to remit payments to third parties if a member does not have sufficient funds in his account to make a payment. The authorization form will also include the member's agreement to the release of information

necessary to facilitate the withdrawal of his funds through the program.

- (c) All preauthorizations must be in writing and must indicate the party to whom payment is to be made. Changes to the member's authorization must also be in writing, and will be retained in the credit union's file.
- (d) Adequate internal controls must be established to avoid overdrafting of members' share accounts and to avoid unauthorized withdrawals from one member's account to pay another member's creditors.
- (e) When making preauthorized payments to third parties, the board of directors of a Federal credit union may establish service charges to cover the cost of providing the service. The charge imposed for this service will not exceed the Federal credit union's direct and indirect cost of providing the service.

5220 DELINQUENCY CONTROL

5220.1 NEED FOR DELINQUENCY CONTROL

The number of bad debts is growing for all financial institutions. Many new laws have been enacted which are designed to protect the debtor and, in the process, make it more difficult for lending institutions to recover collateral and overdue payments.

Effective collection procedures and the resulting low delinquency, are one of the best means of sustaining a sound financial condition and continuing quality of member services. This applies to any size credit union which is staffed by volunteers or a paid professional staff. Some of the positive benefits of effective collection procedures are:

- (1) Maximum cash flow will be maintained and funds will be provided to make additional loans and to improve member services.
- (2) Maximum income will be derived as a high level of interest income will be maintained. Dividends can thus be maximized.

- (3) The financial condition will remain sound because reserves will not be drained to offset collection problem loans.

It is easier to control delinquency within a field of membership where members have been educated to repay their debts promptly and it is an accepted fact that delinquency will not be tolerated.

5220.2 ELEMENTS OF DELINQUENCY CONTROL

Delinquency control requires a comprehensive program involving all officials, employees and members. It encompasses many phases of the credit union's operations from lending policies to supervisory committee audits. The essential elements of delinquency control are:

- 1) Lending Policies
- 2) Education of Members
- 3) Collection Policies
- 4) Selection and Training of Personnel
- 5) Identification
- 6) Computation of Delinquency
- 7) Schedule of Delinquent Loans
- 8) Collection Procedures
- 9) Documentation
- 10) Control

(c) Records: (1) The account records of the insured credit union shall be conclusive as to the existence of any relationship pursuant to which the funds in the account are deposited and on which a claim for insurance coverage is founded. Examples would be trustee, agent, custodian, or executor. No claim for insurance based on such a relationship will be recognized in the absence of such disclosure.

(2) If the account records of an insured credit union disclose the existence of a relationship which may provide a basis for additional insurance, the details of the relationship and the interest of other parties in the account must be ascertainable either from the records of the credit union or the records of the member maintained in good faith and in the regular course of business.

(3) The account records of an insured credit union in connection with a trust account shall disclose the name of both the settlor (grantor) and the trustee of the trust and shall contain an account signature card executed by the trustee.

(4) The interests of the co-owners of a joint account shall be deemed equal, unless otherwise stated on the insured credit union's records in the case of a tenancy in common.

(d) Valuation of trust interests: (1) Trust interests in the same trust deposited in the same account will be separately insured if the value of the trust interest is capable of determination, without evaluation of contingencies, except for those covered by the present worth tables and rules of calculation for their use set forth in §20.2031-7 of the Federal Estate Tax Regulations (26 C.F.R. 20.2031-7).

(2) In connection with any trust in which certain trust interests are not capable of evaluation in accordance with the foregoing rule, payment by the Board to the trustee with respect to all such trust interests shall not exceed the basic insured amount of \$100,000.

(3) Each trust interest in any trust established by two or more settlors shall be deemed to be derived from each settlor pro rata to his contribution to the trust.

(4) The term "trust interest" means the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, but does not include any interest retained by the settlor.

§745.3 Single Ownership Accounts.

(a) Funds owned by an individual and deposited in the manner set forth below shall be added together and insured up to \$100,000 in the aggregate.

(1) *Individual accounts.* Funds owned by an individual (or by the husband-wife community of which the individual is a member) and deposited in one or more accounts in the individual's own name shall be insured up to \$100,000 in the aggregate.

(2) *Accounts held by agents or nominees.* Funds owned by a principal and deposited in one or more accounts in the name or names of agents or nominees shall be added to any individual account of the principal and insured up to \$100,000 in the aggregate.

(3) *Custodial loan accounts.* Loan payments received by a Federal credit union prior to remittance to other parties to whom the loan was sold pursuant to Section 107(13) of the Federal Credit Union Act and Section 701.23 of NCUA's Regulations shall be considered to be funds owned by the borrower and shall be added to any individual accounts of the borrower and insured up to \$100,000 in the aggregate.

(b) Funds held by a guardian, custodian, or conservator for the benefit of his ward or for the benefit of a minor under a Uniformed Gifts to Minors Act and deposited in one or more accounts in the name of the guardian, custodian, or conservator are insured up to \$100,000 in the aggregate, separately from any other accounts of the guardian, custodian, conservator, ward, or minor.

§745.4 Testamentary Accounts.

(a) The term "testamentary account" refers to a revocable trust account, tentative or "Totten" trust account, "payable-on-death" account, or any similar account which evidences an intention that the funds shall pass on the death of the owner of the funds to named beneficiary.

(b) If the named beneficiary of a testamentary account is a spouse, child, or grandchild of the owner, the account shall be insured up to \$100,000 in the aggregate as to each such beneficiary,