NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

August 21, 1987

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4650

Office of General Counsel

Annette N. DeBois, Esq.
Lynch and Printz, P.A.
1717 Louisiana Boulevard, N.E.
Suite 103
Albuquerque, NM 87110

Dear Ms. DeBois:

This is in response to your letter of June 12, 1987, pertaining to the establishment of a leasing program by Member Services, Inc.

Enclosed you will find a copy of NCUA Interpretive Ruling and Policy Statement (IRPS) 83-3 entitled, "FCU Leasing of Personal Property to Members." The scope of 83-3 outlines the permissible guidelines of FCU involvement in direct and indirect leasing programs. The language of 83-3 inherently requires that title of said leased properties vest in the FCU, and accordingly, the FCU is required to maintain contingent liability insurance.

In response to your inquiry concerning the limiting provision of 12 U.S.C. §1757(5)(D), the language of the statute clearly states that loans to CUSO's cannot exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. As with any valid statute, unless expressly provided, waiver is impermissible, and non-adherence is a violation.

Please let us know if you should need any further assistance on this matter.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

Enclosures

SRB:wm

FOIA Index - Vol. I.C.5

**NATIONAL CREDIT UNION ADMINISTRATION**

**Federal Credit Union Leasing of Personal Property to Members**

**Interpretive Ruling and Policy Statement Number 83-3**

Agency: National Credit Union Administration (NCUA)

Action: Interpretive Ruling and Policy Statement 83-3

Summary: The NCUA Board has determinied that when certain requirements are met, leasing of personal property is the functional equivalent of secured lending by Federal credit unions ("FCUs") and, therefore, is a permissible activity.

Effective Date: November 17, 1983.

Although this is a final Ruling, comments will be accepted until January 20, 1984. Send comments to Rosemary Brady, Secretary, NCUA Board, 1776 G Street, N.W., Washington, D.C. 20456. The NCUA Board will review all comments and determine whether substantive amendments to this Ruling are appropriate.

**For Further Information Contact:** Robert M. Fenner, Director , or Hattie M. Ulan, Attorney, Department of Legal Services, National Credit Union Administration, at the above address or telephone: (202) 357-1030.

Supplementary Information:

The NCUA Board has determined that leasing can be the functional equivalent of lending for FCUs. Prevailing Federal case law holds that national banks may, as a proper exercise of their incidental powers, engage in certain forms of leasing as the functional equivalent of lending. (See, M & M Leasing Corporation v. Seattle First National Bank, 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978).) The NCUA Board has concluded that, by analogy, an FCU may engage in lease financing for personal property to its members as long as the leases are the functional equivalent of secured loans for personal property. That is, the lessor (FCU) may not assume burdens or subject itself to risks greater than those ordinarily incident to a secured loan. M & M Leasing suggests certain criteria for leases so that they are the functional equivalent of secured loans.

In order to be considered permissible leases, Federal credit unions must enter into net, full payout leases. Both the net and

full payout requirements were cited by the court in M & M Leasing as indicia of a permissible leasing transaction. A net lease places all of the burdens of ownership on the lessee who is responsible for maintenance and repair, purchasing of parts and accessories, renewal of licensing and registration and insurance on the leased property. Lessees are required to maintain insurance on leased property. The full payout requirement means that over the term of the lease the lessor must recoup its entire investment in the leased property plus the cost of the financing. The lessor's return will come from the monthly payments made by the lessee, estimated tax benefits (although these will not be used directly by FCUs, considering their tax-exempt status) and the estimated residual value of the property. The residual value of the property is determined at the outset of the lease. It is the value of the property at lease end that will be relied upon by the FCU to meet the full payout requirement. In M & M Leasing, supra, the court states that the residual value of the leased property at the expiration of the lease may contribute only insubstantially to the recovery under the lease. Following the example of the Office of the Comptroller of the Currency, the NCUA Board has determined that FCUs shall place a maximum limit of 25 percent of the original cost of the leased item on residual value estimates to be relied upon to meet the full payout requirement. Higher estimates will be allowed if the residual

value is guaranteed by a financially capable party. The guarantor may be the manufacturer, the lessee or a third party who is not an affiliate of the FCU. In all cases, the residual value relied upon must be reasonable in light of the circumstances. This policy is adopted so that FCUs will not place excessive reliance on residual values that may be somewhat speculative and may, therefore, subject FCUs to increased risk.

Federal credit unions may engage in both open-end and closed-end leasing. The responsibility for depreciation costs determines whether the lease is open or closed end. In open-end leasing, the lessee member takes responsibility for any decrease between the relied upon residual value of the property and its actual value at lease end. In closed-end leasing, the FCU takes on this responsibility. The lessee is always responsible for a decrease in value due to excessive wear and tear on the leased property. Closed-end leasing presents greater risk for the FCU whereas open-end leasing places the greater risk on the lessee member. This risk is not substantial, however, due to the 25 percent limit placed on residual values for full payout purposes discussed in the preceding paragraph.

Federal credit unions may engage in both indirect and direct leasing. In indirect leasing, the FCU purchases the lease and the leased property after the lease has been executed between a vendor and an FCU member. In direct leasing, the FCU will become

the owner of personal property at the request of the lessee member who wishes to lease it from the FCU. The FCU will purchase the property from a vendor and then lease it to the member.

It is the understanding of the NCUA Board that the common practice of most financial institutions engaging in lease financing is to maintain a contingent liability insurance policy with an endorsement for leasing. This is used to protect the financial institution should it be sued as owner of the leased property. Federal credit unions participating in leasing must maintain a contingent liability insurance policy with an endorsement for leasing to protect themselves from loss.

The FCU should also retain certain salvage powers over the leased property. Thus, if the FCU in good faith believes that there has been an unanticipated change in conditions (e.g., failure of lessee to maintain insurance or to properly license and register leased property, among other things) that threaten its financial position by significantly increasing its exposure to risk, the FCU shall not be subject to the net, full payout requirements discussed above and may: (1) as the owner and lessor under a net, full payout lease, take reasonable and appropriate action to salvage or protect the value of the property or its interests arising under the lease; or (2) as the assignee of a lessor's interest in a lease, become the owner and lessor of the

leased property pursuant to its contractual right and/or take any reasonable and appropriate action to salvage or protect the value of the property or its interests arising under the lease.

In M & M Leasing the court recognized that national banks were not subject to state usury laws while engaging in leasing. The NCUA Board has determined that the usury ceiling for FCUs does not apply to their leasing function, because while the functional equivalency of leasing and lending is recognized, they are not legal equivalents. The Office of the Comptroller of the Currency and the Federal Home Loan Bank Board have determined that usury ceilings are inapplicable to their respective regulated financial institutions while engaging in lease financing under the authority granted by M & M Leasing, supra. In any event, all financial institutions, including Federal credit unions, are subject to the requirements of the Consumer Leasing Act and Regulation M, which implements that Act, while engaging in consumer lease financing. The Consumer Leasing Act and Regulation M require that certain disclosures be made in all consumer leases so that the consumer lessee will be able to compare various lease terms available.

**INTERPRETIVE RULING AND POLICY STATEMENT 83-3** - Federal credit unions may engage in leasing of personal property to their members when certain requirements are met. The leases may be either direct or indirect and either open end or closed end. The leases must be net, full payout leases, with a maximum limit of 25 percent residual value to be relied upon for the full payout requirement. Any reliance beyond the 25 percent is permissible if guaranteed. Federal credit unions shall retain salvage powers over the leased property. Federal credit unions are not subject to the usury ceiling while engaging in lease financing. Federal credit unions engaging in leasing must maintain a contingent liability insurance policy with an endorsement for leasing.

By the National Credit union Administration Board on November 10, 1983.

Rosemary Brady

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Secretary of the Board