



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

August 31, 1987

GC/SRB:sg
4630

Office of General Counsel

Mr. Ron Anderson
Assistant Manager
Power-Tech Federal Credit Union
P.O. Box 4388
Vancouver, WA 98662

Dear Mr. Anderson:

This is in reply to your letter dated August 18, 1987, to Mr. James Engel concerning your plan to offer a 3 1/2% loan fully secured by zero-dividend shares. I recently had the opportunity to respond to another Federal credit union in Vancouver on the same matter. I have enclosed a copy of this letter for your review. It should provide the answers to the questions you have raised.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

SRB:sg

Enclosure



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

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4330

August 7, 1987

Office of General Counsel

Ms. Marie Nunn
Manager
Northwest Navigation Federal Credit Union
P.O. Box 831
Vancouver, Washington 98666

Dear Ms. Nunn:

This responds to your recent letter requesting our review and opinion concerning a proposal currently under consideration by your Credit Union. As outlined in your letter, your Credit Union proposes to implement a dividend structure that will pay a reduced dividend rate on shares that have been pledged by members to secure loan obligations and charge a lower rate of interest on such share-covered loans. Your board of directors is considering such a combined deposit/credit arrangement due to various tax consequences.

Section 117 of the Federal Credit Union Act (12 U.S.C. §1763) provides that the FCU board of directors may, after provision for required reserves, pay a dividend at different rates on different types of shares. Therefore, your board could create a special share account classification which could be tied with a special low interest loan agreement.

Section 701.35 of NCUA's Rules and Regulations requires an FCU's accounts to accurately reflect the terms and conditions of the members' accounts (12 C.F.R. §701.35). The FCU's account agreements would have to accurately reflect the interplay between the members' share account and outstanding loan in terms of interest rate charged on the loan, dividends to be paid on the share account, and access to the frozen shares.

The power of the FCU board of directors to set interest rates on loans is governed by Section 107(5)(A)(vi)(I) of the FCU Act (12 U.S.C. §1757(5)(A)(vi)(I)). Within these guidelines, an FCU board of directors may set the interest rates on FCU loans and lines of credit.

The NCUA has issued guidelines concerning deposit balances required by an FCU in connection with a loan to a member. Enclosed is IRPS 79-9 concerning compensating balance deposits

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which, if determined to be such, would have to be considered in calculating the rate of interest on an FCU loan to a member for purposes of Section 107(5)(A)(vi)(I) of the FCU Act.

Generally, under IRPS 79-9, if an FCU grants a loan to a member and requires a portion of the loan or an amount of money from an outside source to be deposited in a frozen share account or other type of account at the FCU for the life of the loan, then the account would be considered a compensating balance and the computation provisions of IRPS 79-9 would apply. The term "compensating balance" does not include any deposit in the FCU that the member/borrower has made previously without regard to any loan requirement or lending policy that such a deposit be made, even though the account is given as security for the loan.

In addition to satisfying the requirements of IRPS 79-9, the FCU board must comply with the Truth in Lending Act (15 U.S.C. 1601 et seq.) and Regulation Z (12 C.F.R. §226 et seq.). The definition of a finance charge is found at §226.4(a) of Regulation Z. The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the creditor as an incident to or a condition of the extension of credit. The Official Staff Interpretation to Section 226.4(a) found in Supplement I to Regulation Z discusses forfeitures of interest. As explained below, in some instances a forfeiture of interest on a member's deposit must be reflected in the finance charge. The Official Interpretation states in part that:

"If the creditor reduces the interest rate it pays or stops paying interest on a consumer's deposit or any portion thereof . . . the interest lost is a finance charge. . . . A consumer must be entitled to the interest that is not paid on an account in order for the lost interest to be a finance charge."

We have contacted the Consumer Affairs Division of the Federal Reserve Board for their comment on this interpretation. It is their opinion that one must look to the deposit contract of the member to determine whether or not the member is entitled to the interest (or dividend in the case of a credit union). It is our understanding that if the deposit contract entitles a member to the dividend, the amount of forfeiture would be a part of the finance charge. For example, if a member enters into a combined share account/line of credit agreement with the FCU where the share account may pay a 1% dividend and there is a 5% interest rate on the line of credit, there is no forfeiture of dividends since the member was never entitled to more than a 1% dividend on the share account. On the other hand, if a member has a share certificate account paying a 6% dividend and then enters into a credit

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agreement which will offer a loan at 18 but will stop paying dividends on the share certificate account for the life of the loan even though other similar accounts (without the loan tie-in) receive dividends, an interest or dividend forfeiture occurs and the forfeiture is part of the finance charge.

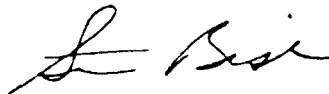
In addition, pursuant to Section 226.18(r) and footnote 45 of Regulation Z, 12 C.F.R. §226.18(r) (for closed-end credit only) if a creditor requires a deposit as a condition of a specific transaction and the deposit earns less than five percent per year, the creditor must disclose that the annual percentage rate does not reflect the effect of the required deposit.

You may wish to have your attorney review any combined share account/credit agreement for compliance with Regulation Z.

Lastly, we would caution you that there may be personal income tax consequences to your members, and reporting obligations on the part of the Credit Union, that you should determine by consulting with your attorney or the Internal Revenue Service.

I hope we have been of assistance.

Sincerely,



STEVEN R. BISKER
Assistant General Counsel

RD:sg

Enclosure