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NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

November 6, 1987

Office of General Counsel

Kenneth P. Kosut, Esq.
Cruver & Evans
Three Riverway
Suite 1776
Houston, Texas 77056

Dear Mr. Kosut:

This is response to your letter of April 30, 1987, which asked whether it is permissible for Federal credit unions (FCU's) to lease personal property to members for business purposes.

Under your proposal, the FCU would lease equipment specified by the lessee and purchased by the FCU from suppliers that are specified by the lessee. The lease transaction would be pursuant to a written lease agreement between the FCU and the member. The lease would be a net, full payout lease, exclusive of any contribution from the personal property's residual value. At the end of the lease term, the lessee would have an option to purchase the personal property for 10% of the then fair market value of the property plus any remaining outstanding rent or other payments due the FCU pursuant to the lease agreement. If the lessee does not exercise the option to purchase, the property would be returned to the FCU for salvage or other disposal. The lease would be carried on the FCU's books as a loan. In addition to the liability and loss insurance carried by the lessee, the FCU would maintain a contingent liability insurance policy with an endorsement for leasing.

As you know, in IRPS 83-3 the NCUA Board determined that FCU's may engage in leasing of personal property to their members when certain requirements are met. The following requirements are stated in the IRPS:

> 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

FCU Act ICs Special Loan Plans

> 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.

After reviewing IRPS 83-3, you concluded that the above-described leasing program was permissible for FCU's and that the business loan rules would apply to the leases.

IRPS 83-3 does not directly address the issue of whether it is permissible for FCU's to offer personal property leases to members for business purposes as opposed to consumer purposes. The IRPS was based, in part, upon M & M Leasing Corporation v. Seattle First National Bank, 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978). In M & M Leasing, the authority of national banks to engage in the leasing of motor vehicles and other personal property was challenged. The court held that national banks may, as a proper exercise of their incidental powers, engage in leasing when, in light of all relevant circumstances, the transaction constitutes a loan of money secured by the leased property. While auto leases were at issue in M & M Leasing, the opinion also refers to leases for "big ticket items" such as aircraft and ships. The court did not distinguish between consumer lease financing and business lease financing and neither does IRPS 83-3. Therefore, we conclude that FCU's have the authority to engage in leases of personal property for business purposes, provided the leases comply with the IRPS as well as the rules discussed below.

As you concluded in your letter, the new business loan rules, which are contained in Section 701.21(h) of the NCUA Rules and Regulations, would apply to business leases. Since the authority of FCU's to engage in certain leases derives from the determination that these leases are the functional equivalent of secured loans for personal property, the leases would also be subject to other requirements of Section 701.21 that apply to business and nonbusiness loans generally. The sole exception to this statement is the usury limitation. As stated in the IRPS, FCU's are not subject to the usury ceiling when engaging in lease financing.

You argued in your letter that Article XII, Section 1 of the FCU Bylaws should not apply to the leasing of personal property for business purposes. This Section provides that loans to a nonnatural member shall not exceed the member's shareholdings in the FCU. You argued that the intent of this provision was "to protect the credit union's individual, natural person membership from loan defaults by corporations and other business entities by making available the security of the share account." You stated that, "such a limitation is consistent with the original and basic purpose of the credit union, i.e., to service the personal credit requirements of its individual members." You further

stated that with respect to the leasing of personal property for business purposes, the protection afforded by the bylaw, i.e., the shareholder account, is unnecessary in the leasing situation as the "security" exists in the form of the personal property itself. You concluded that, since leases are not legally equivalent to loans, the bylaw would not apply.

We can see no legitimate reason for exempting leases from coverage under the bylaw. The purpose of Article XII, Section 1 of the FCU Bylaws was not simply to provide security for loans made to nonnatural persons, but was to ensure that the FCU would retain funds for consumer lending and not invest all its funds in loans to nonnatural persons. While the bylaw requires that loans to nonnatural persons not exceed their shareholdings in the FCU, it does not require that the shares be pledged to secure the loan. In light of the rationale of the bylaw, your argument that the security provided by the bylaw is not necessary in the leasing situation is not persuasive. We would further note that, in terms of the ultimate satisfaction of the lease obligation, the position of the FCU as owner of the leased property does not differ significantly from the secured position of an FCU in a secured loan agreement.

As leases are the functional equivalent of loans, the bylaw should apply to leases as well as loans. We would note that, in conjunction with the business loan rules, the NCUA approved a standard bylaw amendment. The standard bylaw amendment, if adopted by an FCU, would permit the FCU to make a loan to a nonnatural member that exceeds the member's shareholdings in the FCU if the loan is made jointly to one or more natural person members and a business organization in which they have a majority ownership interest, or, if the nonnatural person is an association, the loan is made jointly to a majority of the members of the association and to the association in its own right.

You enclosed an equipment lease agreement with your letter. You stated that this lease or a similar lease would be used by the FCU. The terms of the lease agreement not covered by IRPS 83-3 or Section 701.21 must be determined by the parties in accordance with the relevant state law. The leasing program you described in your letter meets the requirements of the IRPS.

We trust this has been of assistance.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

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