



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

August 4, 1988

GC/RD: 50
4/6/75

Office of General Counsel

Mr. Thomas A. Troutner
President
Professional Federal Credit Union
1710 St. Joe River Drive
Fort Wayne, IN 46896-5466

RE: Automobile Leasing Program (Your May 10, 1988,
Letter)

Dear Mr. Troutner:

You have requested a review of Professional Federal Credit Union's ("FCU's") auto leasing program for compliance with NCUA regulations. In our view, your leasing program complies with Interpretive Ruling and Policy Statement ("IRPS") 83-3.

BACKGROUND

FCU's program is structured as follows:

- a. An automobile is acquired by Automotive Financial Services (AFS) of Denver, Colorado.
- b. AFS completes a lease agreement between AFS and an FCU member on an FCU-approved leasing application.
- c. AFS assigns the lease to FCU.
- d. The auto is titled to FCU.
- e. The auto is registered to the lessee/member.

FOIA Vol. I Part C (14) Auto Leasing Program

- f. The lessee/member furnishes insurance coverage at an amount set by FCU in the lease contract.
- g. FCU obtains contingent and excess liability insurance and contingent collision and comprehensive insurance and residual value insurance. The residual value insurance covers the market risk that the estimated value of the vehicle at lease maturity meets actual value at lease maturity.

IRPS 83-3

IRPS 83-3 sets forth the requirements for FCU's to engage in leasing personal property to their members. In general, an FCU "may not assume burdens or subject itself to risks greater than those ordinarily incident to a secured loan." [48 Fed. Reg. 52568 (November 21, 1983).]

IRPS 83-3 provides that an FCU may engage in leasing personal property to its members, provided the lease is:

1. direct or indirect - in a direct lease, the FCU purchases the property and leases it to a member. In an indirect lease, the FCU purchases a lease and leased property after the member has executed the lease with the vendor;
2. open-end or closed-end - in an open-end lease, the lessee member is responsible for any difference between the relied-upon residual value of the property and its actual value at lease-end; in a closed-end lease, this risk is placed on the FCU;
3. net lease - where all the burdens of ownership, maintenance, repair, licensing, and insurance rest with the lessee;
4. full pay-out - which requires the lessor FCU to recoup the entire investment in the leased property plus the cost of the financing over the term of the lease. For full pay-out calculations, an FCU is permitted to assume the leased property will have a residual value of up to 25% of the original cost. FCU's may enter into full pay-out leases which assume a higher estimated residual value, provided the residual value over 25% is insured;

Mr. Thomas A. Troutner

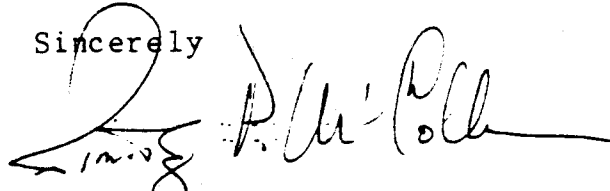
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5. no usury ceiling applies; and
6. the FCU carries contingent liability insurance with an endorsement for leasing.

From the information you submitted, it seems the FCU program markets indirect, closed-end, net, full pay-out leases with residual value insurance. The FCU also carries contingent liability coverage. The program therefore appears to meet the requirements of IRPS 83-3.

Sincerely

A handwritten signature in black ink, appearing to read "Timothy P. McCollum". The signature is written in a cursive style with a long horizontal flourish at the end.

TIMOTHY P. MCCOLLUM
Assistant General Counsel

RD:sg
Enclosure

February 10, 1988

GC/STG
4650

Earl D. Tanner, Esq.
Tanner, Bowen & Tanner
1020 State Street
Salt Lake City, UT 84111

Re: Credit Union Lease Financing (Your Oct. 23, 1987,
Letter)

Dear Mr. Tanner:

The issue you present is as follows: Can a motor vehicle leasing program meet the requirements of Interpretive Ruling and Policy Statement ("IRPS") 83-3 ["Federal Credit Union ("FCU") Leasing of Personal Property to Members"] [48 Fed. Reg. 52568 November 21, 1983] if: (a) the leasing company assigns the lease to the FCU; (b) the leasing company holds title to the vehicle; (c) the FCU is named as the sole lienholder on the vehicle's certificate of title; and (d) the FCU is given an unconditional and irrevocable power of attorney to assign at will title to itself or to any other person as it may choose? In our view, such a leasing program meets the requirements of IRPS 83-3, even though the FCU may not hold legal title to the leased property during the lease term.

IRPS 83-3 sets forth the requirements that enable FCU's to engage in leasing of personal property to their members. In general, an FCU "may not assume burdens or subject itself to risks greater than those ordinarily incident to a secured loan." [48 Fed. Reg. 52568 (November 21, 1983)] More specifically, IRPS 83-3 provides that an FCU may:

engage in leasing of personal property to their members ... [when the leases are] 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 engaging in leasing must maintain a contingent liability insurance policy with an endorsement for leasing.

In adopting IRPS 83-3, the NCUA Board further described the "indirect or direct lease" requirement:

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.

You have pointed out several problems which may practically disable an FCU from engaging in leasing programs if the "direct or indirect lease" provision requires the FCU to become legal titleholder to the property to be leased: In many states, entities engaging regularly in the acquisition and sale or lease of motor vehicles must be licensed as motor vehicle dealers; and in many states, motor vehicle dealers must post bonds and comply with various other state regulatory requirements. These requirements certainly would constitute a significant barrier to FCU's participating in leasing programs in those states.

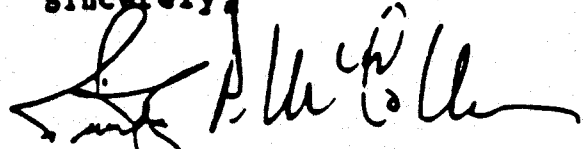
You suggest that a solution to this problem is to have the leasing company: (a) retain legal ownership of the leased vehicles; (b) assign all of its rights in the lease to the FCU (the FCU will receive the lease payments and determine if the lease is in default); (c) name the FCU as the sole lienholder on the vehicles; and (d) give the FCU an unconditional and irrevocable power of attorney to at will assign title to itself or to any other person it may choose. Except for the fact that the FCU will not be the legal titleholder to the leased vehicles, all other requirements of IRPS 83-3 will be met.

We are persuaded that IRPS 83-3 does not require an FCU to acquire legal title to the leased property. In our view, the program you described will not subject the FCU to risks greater

Earl D. Tanner, Esq.
February 10, 1988
Page 3

than those involved in a secured loan, and gives the PCU a sufficient equitable interest in the leased vehicles to satisfy the "ownership" requirement of IRPS 83-3.

Sincerely,



TIMOTHY P. MCCOLLUM
Assistant General Counsel

HMO:bms

cc: Fred Haden, Esq.

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

GC/JT:jt
4650

TO: Director, Examination and Insurance
Michael Riley

FROM: Assistant General Counsel
Timothy P. McCollum

SUBJECT: Proper Accounting Treatment For Auto Leases

DATE: August 4, 1988

Attached is a letter this Office received from BMI FCU and our response to the letter. The letter raises both legal and accounting issues. We have addressed the legal issues. Please respond directly to the FCU regarding the accounting issues. Contact Julie Tamuleviz if you have any questions.

FCU A-001 I C 3 Special Lease



505 KING AVENUE
COLUMBUS, OHIO 43201
614 424-7787

June 20, 1988

Timothy P. McCollum
Assistant General Counsel
National Credit Union Administration

Dear Mr. McCollum,

BMI Federal Credit Union is anticipating a program of auto leasing, and in so doing we are in need of some direction from NCUA in what is permissible and what restrictions are imposed.

We are currently looking at two alternatives:

- (1) An outside leasing company, Security Excel Corp., will procure the vehicle with credit union funds and title the vehicle in the credit union name.

Accounting software and processing will be performed by Security Excel Corp.

Question: Must this be in accordance with Section 6090.4 of the Accounting Manual?
What FASBs are involved?

Contingent liability insurance covering BMI FCU will be purchased through Security Excel Corp.

Disposal of the returned lease vehicle will be under direction of the credit union, with residual value being guaranteed by a third party insurance carrier.

Question: What Federal Regulation will govern this activity and what restrictions, if any, apply to aggregate outstanding balances?

- (2) An outside leasing company, Stone Leasing Co., will procure the vehicles with credit union funds, title the vehicles in the name of Stone Leasing Co., and assign the leases to the credit union.

Accounting software and processing will be performed by BMI FCU.

Question: Must this be in accordance with Section 6090.4 of the Accounting Manual?
What FASBs are involved?

(2)



505 KING AVENUE
COLUMBUS, OHIO 43201
614 424-7787

Contingent liability insurance covering the credit union will be purchased by BMI FCU through independent insurance carrier.

Disposal of the returned lease vehicle will be under direction of Stone Leasing Co. with residual value guaranteed by a third party insurance carrier.

Question: What Federal Regulation will govern this activity and what restrictions, if any, apply to aggregate outstanding balances?

It is our understanding from Security Excel Corp. that they have already received an interpretive letter confirming their procedures to be acceptable. We would appreciate your confirmation of this fact.

With so many various leasing programs being used in credit unions and CUSOs, we would feel more confident in proceeding after the above questions have been answered and the two situations analyzed.

Your help in this matter is greatly appreciated. Thank you.

Sincerely yours,

Shirley Unverzagt
Shirley Unverzagt
Vice President

SU



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

August 4, 1988

GC/JT-3
4650

Office of General Counsel

Ms. Shirley Unverzagt
Vice President
BMI Federal Credit Union
505 King Avenue
Columbus, Ohio 43201

Re: Federal Credit Union ("FCU") Involvement in Auto
Leasing (Your June 20, 1988, Letter)

Dear Ms. Unverzagt:

You have asked several questions regarding FCU involvement in an auto leasing program. NCUA's Interpretive Ruling and Policy Statement ("IRPS") 83-3 sets forth the requirements that enable FCU's to engage in leasing of personal property to their members. I am enclosing a copy of the IRPS for your review. Your letter does not provide sufficient facts to determine whether the leasing programs you are considering are permissible for FCU's. However, we may be able to provide some initial guidance.

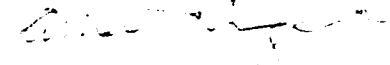
One of the leasing programs you are looking at would involve an outside leasing company that would procure autos with credit union funds, title the autos in the name of the leasing company, and assign the leases to the credit union. We have recently stated our view that a leasing program could qualify under IRPS 83-3 if the title of the leased property was held by the leasing company, provided: (1) the leasing company assigns all of its rights in the lease to the FCU; (2) the FCU is named as the sole lienholder on the autos; and (3) the leasing company executes an unconditional power of attorney to the FCU allowing the FCU to transfer title without notice to the leasing company. A copy of this opinion is enclosed.

You also raised several accounting questions regarding auto leases. NCUA's Office of Examination and Insurance will respond to those inquiries separately.

You asked if we had reviewed the Security Excel Corporation's auto leasing program. We have recently given an opinion on a

very narrow issue to Security Funding Corp.; a copy is also enclosed. He will need more information (date of inquiry, date of response) to try to locate a letter to Security Excel itself.

Sincerely,


TIMOTHY P. McCOLLUM
Assistant General Counsel

JT:sz

Enclosures

February 10, 1988

GC/JT.sg
4650

Earl D. Tanner, Esq.
Tanner, Bowen & Tanner
1020 State Street
Salt Lake City, UT 84111

Re: Credit Union Lease Financing (Your Oct. 23, 1987,
Letter)

Dear Mr. Tanner:

The issue you present is as follows: Can a motor vehicle leasing program meet the requirements of Interpretive Ruling and Policy Statement ("IRPS") 83-3 ["Federal Credit Union ("FCU") Leasing of Personal Property to Members"] [48 Fed. Reg. 52568 November 21, 1983]] if: (a) the leasing company assigns the lease to the FCU; (b) the leasing company holds title to the vehicle; (c) the FCU is named as the sole lienholder on the vehicle's certificate of title; and (d) the FCU is given an unconditional and irrevocable power of attorney to assign at will title to itself or to any other person as it may choose? In our view, such a leasing program meets the requirements of IRPS 83-3, even though the FCU may not hold legal title to the leased property during the lease term.

IRPS 83-3 sets forth the requirements that enable FCU's to engage in leasing of personal property to their members. In general, an FCU "may not assume burdens or subject itself to risks greater than those ordinarily incident to a secured loan." [48 Fed. Reg. 52568 (November 21, 1983)] More specifically, IRPS 83-3 provides that an FCU may:

engage in leasing of personal property to their members ... [when the leases are] 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

Earl D. Tanner, Esq.
February 10, 1988
Page 2

guaranteed.... Federal credit unions engaging in leasing must maintain a contingent liability insurance policy with an endorsement for leasing.

In adopting IRPS 83-3, the NCUA Board further described the "indirect or direct lease" requirement:

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.

You have pointed out several problems which may practically disable an FCU from engaging in leasing programs if the "direct or indirect lease" provision requires the FCU to become legal titleholder to the property to be leased: In many states, entities engaging regularly in the acquisition and sale or lease of motor vehicles must be licensed as motor vehicle dealers; and in many states, motor vehicle dealers must post bonds and comply with various other state regulatory requirements. These requirements certainly would constitute a significant barrier to FCU's participating in leasing programs in those states.

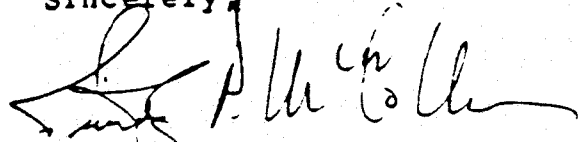
You suggest that a solution to this problem is to have the leasing company: (a) retain legal ownership of the leased vehicles; (b) assign all of its rights in the lease to the FCU (the FCU will receive the lease payments and determine if the lease is in default); (c) name the FCU as the sole lienholder on the vehicles; and (d) give the FCU an unconditional and irrevocable power of attorney to at will assign title to itself or to any other person it may choose. Except for the fact that the FCU will not be the legal titleholder to the leased vehicles, all other requirements of IRPS 83-3 will be met.

We are persuaded that IRPS 83-3 does not require an FCU to acquire legal title to the leased property. In our view, the program you described will not subject the FCU to risks greater

Earl D. Tanner, Esq.
February 10, 1988
Page 3

than those involved in a secured loan, and gives the FCU a sufficient equitable interest in the leased vehicles to satisfy the "ownership" requirement of IRPS 83-3.

Sincerely,



TIMOTHY P. MCCOLLUM
Assistant General Counsel

HMU:bms

cc: Fred Haden, Esq.

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 determined 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

Rosemary Brady

Secretary of the Board