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NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

October 13, 1988

Office of General Counsel

Mr. James M. Still, Jr.
President, Credit Union Lease Plans Inc.
P.O. Box 351
Palmyra, NJ 08065

Re: Credit union leasing
(Your July 28, 1988, letter)

Dear Mr. Still:

You requested several letters issued by this Office concerning credit union leasing and balloon loans. Enclosed are the letters you requested and a copy of NCUA's 1983 Interpretive Ruling and Policy Statement ("IRPS") 83-3 entitled "Federal Credit Union Leasing of Personal Property to Members". We have done nothing more in this area to this point.

You also asked the procedure for obtaining a private opinion letter from this Office. We will respond to questions that you have regarding the Federal Credit Union Act, NCUA's Rules and Regulations and IRPS's that we have issued. We ask that you forward any questions to us in writing if you wish a written response.

Sincerely,

TIMOTHY P. McCOLLUM
Assistant General Counsel

Enclosures

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NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

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Office of General Counsel

Gary P. Bosco, Esquire
Suite 900
1275 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Bosco:

This is in response to your letter of November 27, 1985, concerning Interpretive Ruling and Policy Statement (IRPS) 83-3--Federal Credit Union Leasing of Personal Property to Members.

You first ask whether, pursuant to the IRPS, an FCU can become a lienor with a security interest in the leased vehicles rather than obtaining legal title to the vehicles? Under this arrangement, the leasing company, rather than the FCU, would enter into the lease transaction with the member. Further, the FCU would be making loans to the leasing company for the purchase of the vehicles to be leased.

As you know, an FCU cannot make a loan to a leasing company unless the leasing company is a member of the FCU or is otherwise eligible to obtain a loan from the FCU (e.g., a CUSO). Therefore, in response to your first question, it would be permissible for an FCU to engage in a leasing program in this manner provided the loans made under such an arrangement are made to a lessor eligible to obtain loans from the FCU.

Next, you inquire whether FCU's must maintain contingent liability policies under leasing plans. The preamble to IRPS 83-3 states that all of the burdens of ownership of a leased vehicle are to be placed on the lessee. This includes the responsibility to maintain insurance on the vehicle. As addressed in the IRPS, NCUA requires that the lessor FCU maintain a contingency liability policy with an endorsement for leasing should the FCU be sued as the owner of the vehicle. FCU's must obtain this insurance coverage whether it be through an individual or blanket policy.

Lastly, you inquire whether the IRPS would permit the residual value of a leased vehicle to be guaranteed by the leasing company. The IRPS requires that any residual value relied upon in excess of 25% of original cost be guaranteed. The preamble explains that the guarantee may be provided by a financially

capable party that is not an affiliate of the FCU. As long as the leasing company is not affiliated with the FCU (e.g., leasing company is not a CUSO of the FCU), such a guarantee would be permissible.

We hope that we have been of assistance. If further questions arise, please contact Hattie Ulan of this Office.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

HMU:cch

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

February 10, 1988

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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

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
Washington, D.C. 20456

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June 19, 1987

Office of General Counsel

Mr. Tom E. Walker
Vice President for Administration
Suncoast Schools Federal Credit Union
Tampa, Florida 33680

Dear Mr. Walker:

This is in response to your letter concerning Federal credit union ("FCU") involvement in repurchase balloon loan programs.

We recently addressed the involvement of FCU's in repurchase balloon loan programs in a letter to Mr. Timothy Woodrum. A copy of that letter is enclosed. FCU's may continue or begin to offer repurchase balloon loan programs until we have completed our current review of such programs. If our review leads us to the conclusion that repurchase balloon loans are permissible only if certain criteria are met, all FCU programs will be required to conform to those criteria.

Thank you for your input on this issue.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

HMU:sg

Enclosure

NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

May 4, 1987

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Office of General Counsel

Mr. Timothy Woodrum
Treasurer
Cartel Enterprises, Inc.
Suite 210
Fort Lauderdale, FL 33308

Dear Mr. Woodrum:

This is in response to your letters of February 26, April 10, and April 23, 1987, and our telephone conversation of April 23, 1987, concerning repurchase and conventional balloon loans involving Federal credit unions ("FCU's").

According to the program described in the letters, your company is involved in providing residual value insurance to FCU's that engage in repurchase balloon loans with their members. As stated in our December 11, 1986, letter to Mr. Randall McCathren (enclosed), a repurchase balloon loan program is not consistent with the generally accepted definition of a loan since it gives the borrower an option to return property rather than money. In addition, a repurchase balloon loan does not meet the requirements of a permissible lease for FCU's pursuant to Interpretive Ruling and Policy Statement 83-3. We are presently reexamining repurchase balloon loans and their legality for FCU's. We have been informing FCU's and other entities involved in FCU repurchase balloon loan programs that they may continue to participate in such programs pending the completion of our current review. If our review leads us to the conclusion that repurchase balloon loans are permissible if certain criteria are met, all FCU programs will be required to conform to those criteria.

As discussed in our telephone conversation and as noted in our letter to Mr. McCathren, FCU's may make conventional balloon loans to their members. You noted that your program could be modified so that the FCU would provide conventional balloon loans rather than repurchase balloon loans to its members. As you know, the loan documents for conventional balloon loans do not contain a provision giving the member an option of returning the vehicle instead of paying the lump sum amount at the maturity of the loan. Your April 23 letter contains the statement that ". . . Cartel's program is structured in such a manner that the loans offered are considered conventional balloon loans . . . ." (Emphasis added.) So that there is no further misunderstanding, our opinion on the permissiblity is based upon your

representation that the loans are (as opposed to "considered") conventional balloons as we have described such loans in this letter.

Under your plan, the participating FCU would facilitate its members' purchase of residual value insurance through your company. An FCU may make insurance plans of third party vendors available to its membership pursuant to Part 721 of the NCUA Rules and Regulations (12 C.F.R. Part 721), copy enclosed. Your attention is specifically directed to the reimbursement provisions of that regulation (see Section 721.2).

In conclusion, an FCU may make conventional balloon loans (i.e. loans that do not involve a repurchase option) and offer a third party vendor's residual value insurance plan to its members. Of course, such loans must be in compliance with Section 1757(5) of the FCU Act (12 U.S.C. §1757(5)) and Section 701.21 of the NCUA Rules and Regulations (12 C.F.R. §701.21) (NCUA statutory and regulatory provisions governing loans) and any other applicable Federal or state law. Lastly, FCU involvement in a third party vendor insurance plan must comply with Part 721 of the NCUA Rules and Regulations.

I hope that we have been of assistance.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

HMU:sg

cc: Jeffrey Burris, Esq.
Randall McCathren

Enclosures

Part 721

Federal Credit Union Insurance and Group Purchasing Activities

§721.1 Authority

A federal credit union may make insurance and group purchasing plans involving outside vendors available to the membership (including endorsement), and may perform administrative functions on behalf of the vendors.

§721.2 Reimbursement.

(a) For purposes of paragraph (b) of this section, the following definitions shall apply:

(1) "Dollar amount" shall mean $4 per single payment policy, $6 per combination policy, or $4 per annum for any other type of policy; and

(2) "Cost amount" shall mean the total of the direct and indirect costs to the Federal credit union of any administrative functions performed on behalf of the vendor. The Federal credit union must be able to justify this amount using standard accounting procedures.

(b) A Federal credit union may be reimbursed or compensated by a vendor for activities performed under § 721.1 as follows:

(1) Except as otherwise provided by applicable state insurance law, reimbursement or compensation is not limited with respect to insurance sales by the credit union or its employees which are directly related to an extension of credit by the credit union or directly related to the opening or maintenance of a share, share draft or share certificate account at the credit union;

(2) For insurance sales other than those described in paragraph (b)(1), a Federal credit union may receive an amount not exceeding the greater of the dollar amount or the cost amount;

(3) For group purchasing plans other than insurance, a Federal credit union may receive an amount not exceeding the cost amount.

(c) No official or employee of a Federal credit union or any immediate family member of an official or employee may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this regulation. For purposes of this section, "immediate family member" means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or spouse of any such individual.

NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

December 11, 1986

Office of General Counsel

Mr. Randall McCathren
Executive Vice President
Bank Lease Consultants Inc.
3401 West End Avenue
Nashville, TN 37203

Dear Mr. McCathren:

This is in response to your letter concerning conventional balloon loans and repurchase balloon loans and whether these programs are permissible for Federal credit unions (FCU's). We apologize for the delay in our response.

Conventional balloon loans differ from traditional loans in that there is a lump sum (balloon) payment due at the end of the financing period. FCU's can make balloon loans pursuant to Section 107(5) of the FCU Act (12 U.S.C §1757(5)) and Section 701.21 of the NCUA Regulations (12 C.F.R. §701.21). Conventional balloon loans are subject to the same requirements as other FCU loans. You analogize the conventional balloon program to an open-end lease program permissible for FCU's pursuant to Interpretive Ruling and Policy Statement 83-3 - FCU Leasing of Personal Property (IRPS 83-3). IRPS 83-3 has no bearing on an FCU's authority to offer conventional balloon loans. They are loans rather than leases and no analogy to permissible leases need be made.

The repurchase balloon loan differs from the conventional balloon loan in that, in addition to a lump sum (balloon) payment being due at the end of the financing period, the borrower has the option of returning the property (vehicle) to the FCU at the end of the financing period for a predetermined residual value in lieu of the balloon payment. We do not view the repurchase balloon loan program as a loan of money. A loan of money is a delivery of a sum of money to another under a contract to return at some future time an equivalent amount with or without interest. (See, e.g, Boerner v. Colwell Co., 577 P.2d 200.) The repurchase balloon loan program is not consistent with the generally accepted definition of a loan because it gives the borrower an option to return property rather than money. As you know, the NCUA has authorized FCU's to lease personal property to their members if the leases are the functional equivalent of loans. (See IRPS 83-3.) The repurchase balloon loan program

does not meet the requirements of IRPS 83-3 since the borrower/member has title to the property rather than the FCU.

Under the repurchase balloon program, the FCU is not the lessor as is required by IRPS 83-3. The fact that the repurchase balloon loans are similar in other respects to permissible leasing does not bring them within authorized activities for FCU's. The repurchase balloon program is neither a permissible loan nor lease for FCU's. Rather, it is a hybrid program that is not authorized for FCU's.

In summary, conventional balloon loans are permissible for FCU's while the repurchase balloon loan program is not.

I hope that we have been of assistance.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

HMU:sg

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

Rosemary Brady
Secretary of the Board