



GC/ST:sg ✓
3500

NATIONAL CREDIT UNION ADMINISTRATION

Washington, D.C. 20456

October 21, 1988

Office of General Counsel

Mr. Clint Papesch
President
Transportation Leasing & Services, Inc.
4509 Emery Industrial Parkway
Warrensville Heights, Ohio 44128

Re: Permissibility of FCU Providing Third Party
Vendor with Office Space in FCU (Your July 28,
1988, Letter)

Dear Mr. Papesch:

A Federal credit union ("FCU") offering its members a group purchasing plan pursuant to Part 721 of NCUA's Rules and Regulations [12 C.F.R. Part 721] may permit the vendor offering the service to operate from the FCU. However, to prevent the FCU from becoming liable for acts performed by the third party, we generally urge FCU's to take care to maintain a legal separation from the vendor. Your proposed advertising poses some problems in this regard.

Background

Your company provides auto leasing and auto purchase programs to members of FCU's. You have asked whether it is permissible for an FCU to permit a representative from your company to maintain office space at an FCU for the purpose of marketing the company's services to the FCU's members. The representative will assist members in acquiring autos for purchase or lease, and will provide members with comparisons of available financing alternatives, including FCU financing. The members will be charged a fee for this service. FCU's may become involved in the financing of members' auto leases and purchases.

Analysis

Part 721 of NCUA's Rules and Regulations [12 C.F.R. Part 721] authorizes FCU's to make available to its members group purchasing plans. Section 721.1 provides:

FOIA

Vol. II D Group Purchasing

Mr. Clint Papesch

Page Two

October 21, 1988

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.

An FCU may make auto leasing and auto purchasing plans available to its members under Part 721. The third party making the services available may also work out of the FCU. However, we urge FCU's to make clear to the members that they are dealing with a third party and not the FCU. This is necessary to prevent an FCU from being held liable for acts of the third party. FCU's should take particular care to assure that the advertising for the activity preserves this distinction. In this regard, we have some problems with the advertisement you enclosed with your letter.


The first page of the advertisement contains the FCU's name and logo and then proceeds to discuss an auto service plan being offered to the members. On the second page, under the heading "Your Credit Union is Working For You", the program is described as follows: "No Pressure; Any Make or Model; Payroll Deduction for Convenient and Timely Installments (in most cases); Trade-Ins are Welcome; and Daily Rentals-from \$15/Day (subject to availability)." The inference some might draw is that the service plan is being provided by the FCU rather than your company. You may consider modifying the advertisement.

Your letter does not describe how your auto purchase and leasing program operates. We therefore cannot determine what the FCU's responsibilities will be. You should be aware that Part 721 of NCUA's Rules and Regulations limits an FCU to performing only "administrative functions" on behalf of a third party vendor. Any reimbursement to an FCU by the third party vendor for providing these services is limited by Section 721.2. Finally, an FCU's ability to make auto leases is subject to the requirements of NCUA's Interpretive Ruling and Policy Statement ("IRPS") 83-3. FCU auto loans are subject to Section 107(5) of the FCU Act [12 U.S.C. §1757(5)]

Mr. Clint Papesch
Page Two
October 21, 1988

and Section 701.21 of NCUA's Rules and Regulations [12 C.F.R. §701.21]. We are enclosing a copy of Part 721 and Section 701.21 of NCUA's Rules and Regulations, IRPS 83-3, and a recent opinion interpreting the IRPS for your review.

Sincerely,



TIMOTHY P. MCCOLLUM
Assistant General Counsel

JT:sg

Enclosures

§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.

Part 721

Federal Credit Union Insurance and Group Purchasing Activities

(c) No director, committee member, or senior management employee of a Federal credit union or any immediate family member of any such individual may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this Part. For purposes of this Section, "immediate family member" means a spouse or other family member living in the same household; and "senior management employee" means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) The prohibition contained in subsection (c) also applies to any employee not otherwise covered if the employee is directly involved in insurance or group purchasing activities unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(e) All transactions with business associates or family members not specifically prohibited by subsection (c) must be conducted at arm's length and in the interest of the credit union.

§701.21 Loans to Members and Lines of Credit to Members

(a) *Statement of Scope and Purpose.* Section 701.21 complements the provisions of Section 107(5) of the Federal Credit Union Act (12 U.S.C. §1757(5)) authorizing Federal credit unions to make loans to members and issue lines of credit (including credit cards) to members. Section 107(5) of the Act contains limitations on matters such as loan maturity, rate of interest, security, and prepayment penalties. Section 701.21 interprets and implements those provisions. In addition, Section 701.21 states the NCUA Board's intent concerning preemption of state laws, and expands the authority of Federal credit unions to enforce due-on-sale clauses in real property loans. Also, while Section 701.21 generally applies to Federal credit unions only, its provisions may be used by state-chartered credit unions with respect to alternative mortgage transactions in accordance with Title VIII of Public Law 97-320, and certain provisions apply to loans made by federally-insured state-chartered credit unions as specified in Section 741.3. Finally, it is noted that Section 701.21 does not apply to loans by Federal credit unions to other credit unions (although certain statutory limitations in Section 107 of the Act apply), nor to loans to credit union organizations (which are governed by Section 107(5) (D) of the Act and Section 701.27 of this Part).

(b) *Relation to Other Laws:*

(1) *Preemption of state laws.* Section 701.21 is promulgated pursuant to the NCUA Board's exclusive authority as set forth in Section 107(5) of the Federal Credit Union Act (12 U.S.C. §1757(5)) to regulate the rates, terms of repayment and other conditions of Federal credit union loans and lines of credit (including credit cards) to members. This exercise of the Board's authority preempts any state law purporting to limit or affect:

(i) (A) rates of interest and amounts of finance charges, including:

- (1) the frequency or the increments by which a variable interest rate may be changed;
- (2) the index to which a variable interest rate may be tied;
- (3) the manner or timing of notifying the borrower of a change in interest rate;
- (4) the authority to increase the interest rate on an existing balance;
- (B) late charges; and
- (C) closing costs, application, origination, or other fees;

(ii) terms of repayment, including:

- (A) the maturity of loans and lines of credit;

(B) the amount, uniformity, and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due;

(C) balloon payments; and

(D) prepayment limits;

(iii) conditions related to:

(A) the amount of the loan or line of credit;

(B) the purpose of the loan or line of credit;

(C) the type or amount of security and the relation of the value of the security to the amount of the loan or line of credit;

(D) eligible borrowers; and

(E) the imposition and enforcement of liens on the shares of borrowers and accommodation parties.

(2) *Matters not preempted.* Except as provided by Section 701.21(b) (1), it is not the Board's intent to preempt state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit, for example:

(i) insurance laws;

(ii) laws related to transfer of and security interests in real and personal property (see, however, Section 702.21(g) (6) concerning the use and exercise of due-on-sale clauses);

(iii) conditions related to:

(A) collection costs and attorneys' fees;

(B) requirements that consumer lending documents be in "plain language"; and

(C) the circumstances in which a borrower may be declared in default and may cure default.

(3) *Other Federal law.* Except as provided by Section 701.21(b) (1), it is not the Board's intent to preempt state laws affecting aspects of credit transactions that are primarily regulated by Federal law other than the Federal Credit Union Act, for example, state laws concerning credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices. Applicability of state law in these instances should be determined pursuant to the preemption standards of the relevant Federal law and regulations.

(4) *Examination and Enforcement.* Except as otherwise agreed by the NCUA Board, the Board retains exclusive examination and administrative enforcement jurisdiction over Federal credit unions. Violations of Federal or applicable state laws related to the lending activities of a Federal credit union should be referred to the appropriate NCUA regional office.

(5) *Definition of State Law.* For purposes of Section 701.21(b) "state law" means the constitu-

tion, laws, regulations and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

(c) *General Rules:*

(1) *Scope.* The following general rules apply to all loans to members and, where indicated, all lines of credit (including credit cards) to members, except as otherwise provided in the remaining provisions of Section 701.21.

(2) *Written policies.* The board of directors of each Federal credit union shall establish written policies for loans and lines of credit consistent with the relevant provisions of the Act, NCUA's regulations, and other applicable laws and regulations.

(3) *Credit application.* Consistent with policies established by the board of directors, the credit committee or loan officer shall ensure that a credit application is kept on file for each borrower supporting the decision to make a loan or establish a line of credit.

(4) *Maturity.* The maturity of a loan to a member may not exceed 12 years. Lines of credit are not subject to a statutory or regulatory maturity limit. Amortization of line of credit balances and the type and amount of security on any line of credit shall be as determined by contract between the Federal credit union and the member/borrower.

(5) *Ten percent limit.* No loan or line of credit advance may be made to any member if such loan or advance would cause that member to be indebted to the Federal credit union upon loans and advances made to the member in an aggregated amount exceeding 10% of the credit union's total unimpaired shares and surplus. In the case of member business loans as defined in Section 701.21(h)(1)(i), additional limitations apply as set forth in Section 701.21(h)(2)(ii).

(6) *Early payment.* A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

(7) *Loan interest rates:*

(i) *General.* Except when a higher maximum rate is provided for in Section 701.21(c)(7)(ii), a Federal credit union may extend credit to its members at rates not to exceed 15 percent per year on the unpaid balance inclusive of all finance charges. Variable rates are permitted on the condition that the effective rate over the term of the loan (or line of credit) does not exceed the maximum permissible rate.

دوره - ۱۳۹۰ - ۱۳۹۱

(ii) *Temporary rates:*

(A) *21 percent maximum rate.* Effective from December 3, 1980, through May 14, 1987, a Federal credit union may extend credit to its members at rates not to exceed 21 percent per year on the unpaid balance inclusive of all finance charges. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear rates of interest of up to 21 percent per year after May 14, 1987.

(B) *18 percent maximum rate.* Effective May 15, 1987, a Federal credit union may extend credit to its members at rates not to exceed 18 percent per year on the unpaid balance inclusive of all finance charges.

(C) *Expiration.* After September 9, 1988, or as otherwise ordered by the NCUA Board, the maximum rate on Federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with (A) and (B) above, on loans and line of credit balances existing on or before September 9, 1988.

(8) *Prohibited Fees.* A Federal credit union shall not make any loan or extend any line of credit if, either directly or indirectly, any commission, fee or other compensation is to be received by the credit union's directors, committee members, senior management employees, loan officers, or any immediate family members of such individuals, in connection with underwriting, insuring, servicing, or collecting the loan or line of credit. However, salary for employees is not prohibited by this Section. For purposes of this Section, "senior management employees" means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller), and "immediate family member" means a spouse or other family member living in the same household.

(d) *Loans and Lines of Credit to Officials:*

(1) *Purpose.* Sections 107(5)(A)(iv) and (v) of the Act require the approval of the board of directors of the Federal credit union in any case where the aggregate of loans to an official and loans on which that official serves as endorser or guarantor exceeds \$10,000 plus pledged shares. This Section (701.21(d)) implements the requirement by establishing procedures for determining whether board of directors' approval is required. The section also prohibits preferential treatment of officials.

(2) *Official.* An "official" is any member of the board of directors, credit committee or supervisory committee.

(3) *Initial approval.* All applications for loan or lines of credit on which an official will be either a direct obligor or an endorser, cosigner or guarantor shall be initially acted upon by either the board of directors, the credit committee or loan officer, as specified in the Federal credit union's bylaws.

(4) *Board of directors' review.* The board of directors shall, in any case, review and approve or deny an application on which an official is a direct obligor, or endorser, cosigner or guarantor if the following computation produces a total in excess of \$10,000:

(i) Add:

(A) The amount of the current application.

(B) The outstanding balances of loans including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official.

(C) The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(ii) From the above total subtract:

(A) the amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(B) The amount of shares to be pledge by the official on the loan or line of credit applied for.

(5) *Nonpreferential treatment.* The rates, terms and conditions on any loan or line of credit either made to, or endorsed or guaranteed by

(i) an official

(ii) an immediate family member of an official, or

(iii) any individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official shall not be more favorable than the rates, term and conditions for comparable loans or lines of credit to other credit union members. "Immediate family members" means a spouse or other family member living in the same household.

(e) *Insured, Guaranteed and Advance Commitment Loans.* A loan secured by the insurance or guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of

either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *15 Year Loans.* Notwithstanding the general 12 year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 15 years in the case of (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement, of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one to four family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be excluded on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial

prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal. In lieu of use of a standard security instrument and note, the Federal credit union may have a current attorney's opinion on file stating that the security instrument and note in use meet the requirements of applicable Federal, state and local laws.

(5) *First lien, territorial limits.* The loan shall be secured by a perfected first lien or first security interest in favor of the credit union supported by a properly executed and recorded security instrument. No loan shall be secured by a residence located outside the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico.

(6) *Due-on-sale clauses:*

(i) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by Section 341 of Public Law 97-320 and by any regulations issued by the Federal Home Loan Bank Board implementing Section 341.

(ii) In the case of a contract involving a long-term (greater than twelve years), fixed rate first mortgage loan which was made or assumed, including a transfer of the lien property subject to the loan, during the period beginning on the date a state adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided, the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

(A) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;

(B) the creation of a purchase money security interest for household appliances;

(C) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(D) the granting of a leasehold interest of 3 years or less not containing an option to purchase;

(E) a transfer to a relative resulting from the death of a borrower;

(F) a transfer where the spouse or children of the borrower become an owner of the property;

(G) a transfer resulting from a decree of a dissolution of marriage, a legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(H) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(I) any other transfer or disposition described in regulations promulgated by the Federal Home Loan Bank Board.

(h) *Member Business Loans*

(1) *Definitions*

(i) "Member business loan" means any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, business, or agricultural purpose, except that the following shall not be considered member business loans for the purposes of this section:

(A) A loan or loans fully secured by a lien on a 1 to 4 family dwelling that is:

(1) the member's primary residence; or

(2) the member's secondary residence; or

(3) one other such dwelling owned by the member.

(B) A loan that is fully secured by shares in the credit union or deposits in other financial institutions.

(C) A loan, the proceeds of which are used for a commercial, corporate, business or agricultural purpose, made to a borrower or an associated member (as defined in (iii)), which, when added to other such loans to the borrower or associated member, is less than \$25,000.

(D) A loan, the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, any agency of the Federal government or of a state or any of its political subdivisions.

(ii) "Reserves" means all reserves, including the Allowance for Loan Losses account, and undivided earnings or surplus.

(iii) "Associated Member" means any member with a common ownership, investment or other pecuniary interest in a business or commercial endeavor.

(iv) "Immediate Family Member" means a spouse or other family member living in the same household.

(2) *Requirements.* A Federal credit union may make member business loans only in accordance with the applicable provisions of Sections 701.21 (a) through (g) above and the following additional requirements:

(i) *Written Loan Policies.* The board of directors must adopt specific business loan policies and review them at least annually. The policies shall, at a minimum, address the following:

(A) Types of business loans that will be made.

(B) The credit union's trade area for business loans.

(C) Maximum amount of credit union assets, in relation to reserves, that will be invested in business loans.

(D) Maximum amount of credit union assets, in relation to reserves, that will be invested in a given category or type of business loan.

(E) Maximum amount of credit union assets, in relation to reserves, that will be loaned to any one member or group of associated members, subject to Section 701.21(h) (2) (ii) below.

(F) Qualifications and experience of personnel involved in making and administering business loans.

(G) Analysis of the ability of the borrower to repay the loan.

(H) The following considerations shall be addressed unless the board of directors finds that they are not appropriate for a particular type of business loan and states the reasons for those findings in the credit union's written policies: balance sheet, trend and structure analysis; ratio analysis of cash flow, income and expenses, and tax data; leveraging; comparison with industry averages; receipt and periodic updating of financial statements and other documentation, including tax returns.

(I) Collateral requirements, including loan-to-value ratios; appraisal, title search and insurance requirements; steps to be taken to secure various types of collateral; and how often the value and marketability of collateral is reevaluated.

(J) Appropriate interest rates and maturities of business loans.

(K) Loan monitoring, servicing and follow-up procedures, including collection procedures.

(L) Provision for periodic disclosure to the credit union's members of the number and aggregate dollar amount of member business loans.

(M) Identification, by position, of those senior management employees prohibited by subsection (h)(3) from receiving member business loans.

(ii) *Loans to One Borrower.* Unless a greater amount is approved by the NCUA Board, the aggregate amount of outstanding member business loans to any one member or group of associated members shall not exceed 20% of the credit union's reserves. If any portion of a member business loan is fully secured by a 1 to 4 family dwelling that is the member's primary residence, secondary residence, or one other such dwelling owned by the member, or by shares in the credit union, or deposits in another financial institution, or insured or guaranteed by, or subject to an advance commitment to purchase by, any agency of the Federal government or of a state or any of its political subdivisions, such portion shall not be calculated in determining the 20% limit. Credit unions seeking an exception from the 20% limit must present the Board with, at a minimum: the higher limit sought; an explanation of the need to raise the limit; an analysis of the credit union's prior experience making member business loans; and a copy of its business lending policy.

(iii) *Allowance for Loan Losses.*

(A) The determination whether a member business loan will be classified as substandard, doubtful, or loss, for purposes of the valuation allowance for loan losses, will rely on factors not limited to the delinquency of the loan. Nondelinquent loans may be classified, depending on an evaluation of factors, including, but not limited to, the adequacy of analysis and documentation.

(B) Loans classified shall be reserved as follows:

(1) Loss loans at 100% of outstanding amount;

(2) Doubtful loans at 50% of outstanding amounts; and

(3) Substandard loans at 10% of outstanding amount unless other factors (e.g., history of such loans at the credit union) indicate a greater or lesser amount is appropriate.

(3) *Prohibitions.*

(i) *Senior Management Employees.* A Federal credit union may not make member business loans to the following nonvolunteer, senior management employees, or to any associated member or immediate family member of such employees.

(A) Any member of the Board of Directors who is compensated as such.

(B) The credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager).

(C) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager).

(D) The chief financial officer (Comptroller).

(iii) "*Equity Kickers*." A Federal credit union shall not grant a member business loan where a portion of the amount of income to be received by the credit union in conjunction with such loan is tied to the profit of the business or commercial endeavor for which the loan is made.

(4) *Effective Date*

(i) Section 701.21(h) is effective July 1, 1987. On and after that date, a Federal credit union may make member business loans only after adopting and implementing written loan policies as required by Section 701.21(h)(2)(i). All member business loans made on or after that date must be in full compliance with Section 701.21(h).

(ii) On or before July 1, 1987, a Federal credit union must notify the NCUA Regional Director, in writing, of any outstanding member business loans made prior to that date that do not satisfy the requirements of Section 701.21(h)(2)(ii).

(i) *Put Option Purchases in Managing Increased Interest-Rate Risk for Real Estate Loans Produced for Sale on the Secondary Market.*

(1) *Definitions.* For purposes of this Section 701.21(i):

(i) "Financial options contract" means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract at any time prior to the expiration date specified in the agreement, under terms and conditions established either by (A) a contract market designated for trading such contracts by the Commodity Futures Trading Commission, or (B) by a Federal credit union and a primary dealer in Government securities that are counterparties in an over-the-counter transaction.

(ii) "FHLMC security" means obligations or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Sections 305 or 306 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. §§1454 and 1455).

(iii) "FNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association.

(iv) "GNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Government National Mortgage Association.

(v) "Long position" means the holding of a financial options contract with the option to make or take delivery of a financial instrument.

(vi) "Primary dealer in Government securities" means: (A) a member of the Association of Primary Dealers in United States Government Securities; or (B) any parent, subsidiary, or affiliated entity of such primary dealer where the member guarantees (to the satisfaction of the FCU's board of directors) over-the-counter sales of financial options contracts by the parent, subsidiary, or affiliated entity to a Federal credit union.

(vii) "Put" means a financial options contract which entitles the holder to sell, entirely at the holder's option, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.

(2) *Permitted Options Transactions.* A Federal credit union may, to manage risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates, enter into long put positions on GNMA, FNMA, and FHLMC securities:

(i) if the real estate loans are to be sold on the secondary market within ninety (90) days of closing;

(ii) if the positions are entered into: (A) through a contract market designated by the Commodity Futures Trading Commission for trading such contracts, or (B) with a primary dealer in Government securities;

(iii) if the positions are entered into pursuant to written policies and procedures which are approved by the Federal credit union's board of directors, and include, at a minimum:

(A) the Federal credit union's strategy in using financial options contracts and its analysis of how the strategy will reduce sensitivity to changes in price or interest rates in its commitments to originate real estate loans at specified interest rates;

(B) a list of brokers or other intermediaries through which positions may be entered into;

(C) quantitative limits (e.g., position and stop loss limits) on the use of financial options contracts;

(D) identification of the persons involved in financial options contracts transactions, including a description of these persons' qualifications, duties, and limits of authority; and description of the procedures for segregating these persons' duties;

(E) a requirement for written reports for review by the Federal credit union's board of directors at its monthly meetings, or by a committee appointed by the board on a monthly basis, of: (1) the type, amount, expiration date, correlation, cost of, and current or projected income or loss from each position closed since the last board review, each position currently open and current gains or losses from such positions, and each position planned to be entered into prior to the next board review; (2) compliance with limits established in the policies and procedures; and (3) the extent to which the positions described contributed to reduction of sensitivity to changes in prices or interest rates in the Federal credit union's commitments to originate real estate loans at a specified interest rate; and

(iv) if the Federal credit union has received written permission from the appropriate NCUA Regional Director to engage in financial options contracts transactions in accordance with this Sec-

tion 701.21(i) and its policies and procedures as written.

(3) *Recordkeeping and Reporting.*

(i) The reports described in Section 701.21(i)(2)(iii)(E) for each month must be submitted to the appropriate NCUA Regional Office by the end of the following month.

(ii) The records described in Section 701.21(i)(2)(iii)(E) must be retained for two years from the date the financial options contracts are closed.

(4) *Accounting.* A Federal credit union must account for financial options contracts transactions: (i) in accordance with standards established by the NCUA Board in the *Accounting Manual for Federal Credit Unions* or such other instruction as may be deemed appropriate; or (ii), to the extent not inconsistent with NCUA Board instruction, in accordance with generally accepted accounting standards or principles.

Appendix to Section 701.21(h)—Classifications

Substandard—Loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Doubtful—A loan classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possi-

bility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include: proposed merger, acquisition, or liquidation actions, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss—Loans classified loss are considered uncollectible and of such little value that their continuance as loans is not warranted. This classification does not necessarily mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future.

credit union upon loans made to him in an aggregate amount which would exceed 10 per centum of the credit union's unimpaired capital and surplus.

(B) A self-replenishing line of credit to a borrower may be established to a stated maximum amount on certain terms and conditions which may be different from the terms and conditions established for another borrower.

(C) Loans to other credit unions shall be approved by the board of directors.

(D) Loans to credit union organizations shall be approved by the board of directors and shall not exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. A credit union organization means any organization as determined by the Board, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.

(E) Participation loans with other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the board of directors. *Provided*, That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.

(6) To receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian Tribal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of credit unions serving predominantly low-income members (as defined by the Board) payments, representing equity, on—(A) shares which may be issued at varying dividend rates; (B) share certificates which may be issued at varying dividend rates and maturities; and (C) share draft accounts authorized under Section 205(f); subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board.

(7) To invest its funds (A) in loans exclusively to members; (B) in obligations of the United States of America, or securities fully guaranteed as to principal and interest thereby; (C) in accordance with rules and regulations prescribed by the Board, in loans to other credit unions in the total amount not exceeding 25 per centum of its paid-in and unimpaired capital and surplus; (D) in shares or accounts of savings and loan associations or mutual savings banks, the accounts of which are

insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation; (E) in obligations issued by banks for cooperatives, Federal land banks, Federal intermediate credit banks, Federal home loan banks, the Federal Home Loan Bank Board, or any corporation designated in section ~~240~~ of Title 31 as a wholly owned Government corporation; or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Government National Mortgage Association; or in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Section 305 or Section 306 of the Federal Home Loan Mortgage Corporation Act; or in obligations or other instruments or securities of the Student Loan Marketing Association; or in obligations, participations, securities, or other instruments of, or issued by, or fully guaranteed as to principal and interest by any other agency of the United States and a Federal credit union may issue and sell securities which are guaranteed pursuant to section 306(g) of the National Housing Act; (F) in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more Government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee; (G) in shares or deposits of any central credit union in which such investments are specifically authorized by the board of directors of the Federal credit union making the investment; (H) in shares, share certificates, or share deposits of federally insured credit unions; (I) in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Board: *Provided, however*, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this Act; (J) in the capital stock of the National Credit Union Central Liquidity Facility; and (K) investments in obligations of, or issued by, any State or political subdivision thereof (including any agency, corporation, or instrumentality of a State or political subdivision), except that no credit

9101

12 USC
1454
or
1455

12 USC
1721(c)
GNMT

union may invest more than 10 per centum of its unimpaired capital and surplus in the obligations of any one issuer (exclusive of general obligations of the issuer).

(8) to make deposits in national banks and in State banks, trust companies, and mutual savings banks operating in accordance with the laws of the State in which the Federal credit union does business, or in banks or institutions the accounts of which are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, and for Federal credit unions or credit unions authorized by the Department of Defense operating suboffices on American military installations in foreign countries or trust territories of the United States to maintain demand deposit accounts in banks located in those countries or trust territories, subject to such regulations as may be issued by the Board and provided such banks are correspondents of banks described in this paragraph;

(9) to borrow in accordance with such rules and regulations as may be prescribed by the Board, from any source, in an aggregate amount not exceeding, except as authorized by the Board in carrying out the provisions of title III, 50 per centum of its paid-in and unimpaired capital and surplus: *Provided*, That any Federal credit union may discount with or sell to any Federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital;

(10) to levy late charges, in accordance with the bylaws, for failure of members to meet promptly their obligations to the Federal credit union;

(11) to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him;

(12) in accordance with rules and regulations prescribed by the Board, to sell to members negotiable checks (including travelers checks), money orders and other similar money transfer instruments; and to cash checks and money orders for members, for a fee;

(13) in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Board) of its members and to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union

and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union; and

(14) to sell all or a part of its assets to another credit union, to purchase all or part of the assets of another credit union and to assume the liabilities of the selling credit union and those of its members subject to regulations of the Board;

(15) to invest in securities that—

(A) are offered and sold pursuant to section 4(5) of the Securities Act of 1933 (15 U.S.C. 77d(5)); or

(B) are mortgage related securities (as that term is defined in section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), subject to such regulations as the Board may prescribe, including regulations prescribing minimum size of the issue (at the time of initial distribution) or minimum aggregate sales prices, or both;

(16) to exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated.

§ 1758

§ 108

Bylaws.—In order to simplify the organization of Federal credit unions the Board shall from time to time cause to be prepared a form of organization certificate and a form of bylaws, consistent with this chapter, which shall be used by Federal credit union incorporators, and shall be supplied to them on request. At the time of presenting the organization certificate the incorporators shall also submit proposed bylaws to the Board for its approval.

§ 1759

§ 109

Membership.—Federal credit union membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Board, as may be elected to membership and as such shall each subscribe to at least one share of its stock and pay the initial installment thereon and a uniform entrance fee if required by the board of directors; except that Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district.

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20458

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

Vol 105 - Annual Loan Plans

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.

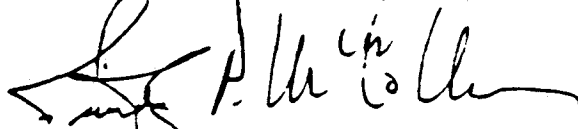
You suggest that a solution to this problem is to have the leasing company: (a) retain legal ownership of the leased vehicles; (b) assign all of its rights in the lease to the FCU (the FCU will receive the lease payments and determine if the lease is in default); (c) name the FCU as the sole lienholder 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