



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

September 26, 1990

Ron Davis, First Vice President
Allison, Rosenblum & Hannahs, Inc.
224 Spring Street
Little Rock, Arkansas 72201

Re: SBA Loans (Your April 10, 1990, Letter)

Dear Mr. Davis:

You have asked us the following questions with regard to Small Business Administration (SBA) loans:

1. Can a 1086 SBA Loan (100% U.S. Government guaranteed portion), a permissible investment, be held in the loan portfolio if (over three years) carried at a lower of cost or market with the zero risk base (while attempting to assemble for redistribution into the secondary market as 1088 certificates)?
2. Can the origination fees or servicing fees which will be created or purchased be held in the investment as well as the loan portfolio?
3. Do 1088 SBA certificates under three years held in investments carry a zero risk base due to the 100% guarantee?

We do not understand questions one and two and ask that you explain them more fully. Although question three cannot be answered with a yes or no, 1088 certificates with a remaining maturity of less than three years are not risk assets under the NCUA regulatory definition.

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Analysis

As we understand the packaging of an SBA loan for resale to investors, the process starts with the SBA guaranteeing up to 90 percent of a business loan from a bank to a borrower. If the bank decides to sell the guaranteed portion of the loan, it sends copies of the loan documents to the SBA Fiscal and Transfer Agent, which obtains written evidence from the SBA that the loan is guaranteed. When these documents are assembled, the Fiscal and Transfer Agent issues a participation certificate evidencing ownership of the insured portion, which the bank can then sell. When the certificate is sold to an investor, the SBA, the lender, and the investor sign a Secondary Participation Guaranty and Certification Agreement (SBA Form 1086), which informs the Fiscal and Transfer Agent where the borrower's payments are to be sent. If the initial investor sells the certificate, SBA Form 1088 is completed, which informs the Fiscal and Transfer Agent of the new owner and where payments are to be sent.

FCU investment in SBA loans is permitted under Section 107(7)(E) of the FCU Act, 12 U.S.C., §1757(7)(E), which authorizes investment in obligations, participations, securities, or other instruments of, issued by, or fully guaranteed as to principal and interest by an agency of the United States. We are confused by the reference, in question one, to a "1086 SBA Loan," since Form 1086 is the document which indicates that an SBA participation certificate has been sold by the lender to an investor. Your assumption that a "1086 SBA Loan" is a permissible investment for credit unions is correct if by that term you mean a participation certificate. If, however, you mean an earlier stage in the process, for example, the purchase of the whole loan directly from the lender, the investment would not be permissible. Section 701.23 of the Rules and Regulations, 12 C.F.R. §701.23, permits FCUs to purchase only loans of its members, loans of a liquidating credit union's members, and certain student and real estate-secured loans. There is no authority for FCU purchase of SBA loans.

What leads us to think that you mean something other than investment in a participation certificate are your references to "the secondary market" and "origination fees or servicing fees." We are confused by your statement in question one

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that the "1086 SBA Loan" is being held "while attempting to assemble for redistribution into the secondary market." When an FCU purchases a participation certificate, the instrument is already in the secondary market. Furthermore, if the FCU wishes to sell the certificate, it need not "assemble" anything to do so. These terms suggest that what you envision is that an FCU act as a broker/dealer for the securities. This interpretation is further supported by your inquiry in question two about where to hold "origination fees or servicing fees which will be created." Such fees are generated around the making or servicing of a loan, not around the purchase and sale of SBA participation certificates. FCUs have no authority to act as broker/dealers for securities. If we have misconstrued your questions, we ask that you explain them more fully.

In response to your third question, Section 700.1(i)(3) of the Rules and Regulations, 12 C.F.R. §700.1(i)(3), provides that assets that have a remaining maturity of three years or less and are fully guaranteed as to principal and interest by a U.S. Government agency are not considered risk assets. A 1088 certificate with a maturity of three years or less meets this definition and would not be considered a risk asset. Its status as a nonrisk asset is due to its maturity as well as its guarantee. A copy of the regulation covering risk assets is enclosed.

I hope that we have been of assistance and apologize for the delay in our response to your questions.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel
Office of General Counsel

Enclosure
GC/LH:sg
SSIC 4660
90-0426

§700.1 Definitions.

As used in this chapter:

- (a) "Act" means the Federal Credit Union Act (73 Stat. 628, 84 Stat. 944, 12 U.S.C. 1751-1795(k)).
- (b) "Administration" means the National Credit Union Administration.
- (c) "Board" means the National Credit Union Administration Board.
- (d) "Credit Union" means a credit union chartered under the Federal Credit Union Act or, as the context permits, under the laws of any State.
- (e) "Regional Director" means the representative of the Administration in the designated geographical area in which the office of the Federal credit union is located.
- (f) "Regional Office" means the office of the Administration located in the designated geographical area in which the office of the Federal credit union is located.
- (g) "State" means a State of the United States, the District of Columbia, any of the several Territories and possessions of the United States and the Commonwealth of Puerto Rico.
- (h) "Remaining maturity" is the time period from the date of the required reserve transfer to the stated date of maturity of the instrument.
- (i) For the purpose of establishing the reserves required by Section 116 of the Federal Credit Union Act, all assets except the following shall be considered risk assets:
- (1) Cash on hand.
 - (2) Deposits and/or shares in federally or stated insured banks, savings and loan associations, and credit unions that have a remaining maturity of 3 years or less.
 - (3) Assets that have a remaining maturity of 3 years or less and are insured by, fully guaranteed as to principal and interest by, or due from the U.S. Government, its agencies, the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation or the Government National Mortgage Association. Collateralized mortgage obligations that are comprised of government guaranteed mortgage loans shall be included in this asset category.
 - (4) Loans to other credit unions that have a remaining maturity of 3 years or less.
 - (5) Student loans insured under the provisions of Title IV, Part B of the Higher Education Act of 1965 (20 U.S.C. 1071, et seq.) or similar state insurance programs that have a remaining maturity of 3 years or less.

Part 700

Definitions

- (6) Loans that have a remaining maturity of 3 years or less and are fully insured or guaranteed by the Federal or a state government or any agency of either.
- (7) Shares or deposits in a central or corporate credit union that have a remaining maturity of 3 years or less. For purposes of defining risk assets a central or corporate credit union is defined as a credit union whose membership primarily consists of:
- (i) Other credit unions organized under state or Federal law,
 - (ii) Officials, committee members, and employees of any credit union organized under state or Federal law, or
 - (iii) Any combination of the categories described in subdivisions (i) and (ii) of this subparagraph.
- (8) Common trust investments, including mutual funds, which deal exclusively in investments authorized by the Federal Credit Union Act that are either carried at the lower cost or market, or are marked to market value monthly.
- (9) Prepaid expenses.
- (10) Accrued interest on non-risk investments.
- (11) Loans fully secured by a pledge of shares in the lending Federal credit union, equal to and maintained to at least the amount of the loan outstanding.
- (12) Loans which are purchased from liquidating credit unions and guaranteed by the National Credit Union Administration.
- (13) National Credit Union Share Insurance Fund Guaranty Accounts established with the authorization of the National Credit Union Administration under the authority of Section 208(a)(1) of the Federal Credit Union Act.
- (14) Investments in shares of the National Credit Union Administration Central Liquidity Facility.

(15) Investments in numbered items 2,3,4,5,6, and 7, with maturities greater than 3 years are exempt from risk assets if the investment is being carried on the credit union's records at the lower of cost or market, or are being marked to market value monthly.

(16) Fixed Assets as defined in Section 701.36(b).

(17) Deposit in the National Credit Union Share Insurance Fund representing a federally insured credit union's capitalization account balance of one percent of insured shares.

(j) (1) *Insolvency.* A credit union will be determined to be insolvent when the total amount of its shares exceeds the present cash value of its assets after providing for liabilities unless:

(i) It is determined by the Board that the facts that caused the deficient share-asset ratio no longer exist; and

(ii) The likelihood of further depreciation of the share-asset ratio is not probable; and

(iii) The return of the share-asset ratio to its normal limits within a reasonable time for the credit union concerned is probable; and

(iv) The probability of a further potential loss to the insurance fund is negligible.

(2) For purposes of this section, the following definitions are used:

(i) "Cash value of assets." Recorded value will be considered the cash value of any asset account providing accepted accounting principles and practices are followed and the provisions of law, regulation, and bylaws are met.

(ii) "Liabilities." Recorded liabilities which are due and payable, excluding shares of members and nonmembers, are considered liabilities.

(k) For purposes of determining the amount required to be transferred to regular reserves under Sections 116 and 201(b)(6) of the Federal Credit Union Act, "gross income" means the total of the operating income accounts reduced by the following.

(1) Dividends received on shares in the National Credit Union Administration Central Liquidity Facility;

(2) Dividends received by credit unions on special share accounts held in Agent members of the Central Liquidity Facility authorized by § 725.7 of this chapter; and

(3) Interest received by an Agent member of the Central Liquidity Facility to the extent of interest paid to the Facility by the Agent member. In the case of an Agent member of the Central Liquidity Facility that is a group of central credit unions —

(i) Interest received by the Agent group representative, as defined in § 725.1(b) of this chapter, to the extent of interest paid to the Facility by the Agent group representative; and

(ii) Interest received by each central credit union in the Agent group (other than the Agent group representative) to the extent of interest paid by each such central credit union to the Agent group representative on Agent group representative loans, as defined in § 725.1(b) of this chapter. Nonoperating gains and losses are not included in gross income.