

January 2, 1990

Al Beltran
Vice President
Hidalgo Federal Credit Union
P.O. Box 4829
McAllen, Texas 78502-4829

RE: Return of Share Drafts
(Your Letter of November 30, 1990)

Dear Mr. Beltran:

You requested a clarification as to whether or not a federal credit union has the right to return a share draft. Specifically, you requested an opinion on the following issue: "If a credit union member is consistently one or more monthly loan payments past due, and at the same time continues to utilize the share draft services of the credit union in a satisfactory manner, does the credit union have the right to return his/her share draft unpaid and marked 'refer to maker'?" The right of a credit union to return share drafts is dependent upon state commercial law and the terms and conditions of the account. The Federal Credit Union ("FCU") Act and the NCUA Rules and Regulations are silent on the issue of returned share drafts. FCUs may make use of a federal statutory lien in such situations as you describe.

ANALYSIS

The FCU Act and the NCUA Rules and Regulations are silent on the issue of returning share drafts. Therefore, it would seem that applicable state commercial law and the contractual terms and conditions of the account in question would control the legality of such a practice. We would recommend that you contact local counsel for an opinion on this practice.

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We note that federal credit unions may make use of the NCUA Interpretive Ruling and Policy Statement No. 82-5 (December 22, 1982) ("IRPS 82-5) (enclosed), entitled "Statutory Lien" in such situations. IRPS 82-5 authorizes an FCU:

- (a) to impress a lien at the time the loan is granted, for instance, by noting the existence of the lien in its records at the same time the loan is granted, by reciting in the loan documents that shares and dividends are subject to the lien or are pledged to secure the loan, or by adopting a bylaw or board policy to the same effect; and
- (b) to enforce the lien by applying the shares and dividends directly to the amount due on the loan without obtaining a court judgment, even if the credit union has allowed the member to make withdrawals and even if a court judgment would be required under state law before a statutory lien could be enforced. IRPS 82-5.

The basis of this authority is Section 107(11) of the FCU Act, which states that an FCU "shall have the power ... 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 U.S.C. §1757(11). The NCUA interprets this statute as giving FCUs a floating lien over the accounts of the member up to the amount of indebtedness owed to the FCU by the member. The lien enables a credit union to take priority over other creditors when claims are asserted against the account of the member.

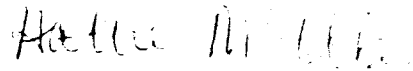
The NCUA does not encourage FCUs to return share drafts as it may leave the public with the impression that the share drafts of an FCU are not viable and affect the credibility of the FCU's share draft program. Furthermore, it could conceivably lead to the FCU being held liable for actual, consequential and incidental damages for losses occasioned by the return of the share draft under applicable state law.

If an FCU desires to expel a member because the FCU has suffered a loss from that member, it may request the FCU membership to expel the member in question. Two-thirds of the members present at a meeting called for the purpose of expelling the member must vote for the expulsion in order for the

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member to be expelled. There are no restrictions as to what reasons constitute cause for expelling a member under this method. 12 U.S.C. §1764(a). The only other method to expel a member is for the member to be expelled for nonparticipation in the FCU. 12 U.S.C. §1764(b). Though this method requires no membership meeting, it may only be used for members not using share, loan or other services of the FCU for a period of time. It could not be used for members otherwise enjoying FCU services who cause a loss to the FCU. We have also stated that an FCU may restrict services to those members who have caused the FCU a loss.

Sincerely,



Hattie M. Ulan
Associate General Counsel

Enclosure

GC/MEC:sg
SSIC 3600
90-1205

NATIONAL CREDIT UNION ADMINISTRATION INTERPRETIVE RULING AND POLICY STATEMENT



IRPS 82-5

DATE: December 22, 1982

NATIONAL CREDIT UNION ADMINISTRATION

12 C.F.R. Part 701

Statutory Lien;

Final Interpretive Ruling and Policy Statement

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Interpretive Ruling and Policy Statement.

SUMMARY: Even if a member's loan is not secured by shares, under the Federal Credit Union Act a Federal credit union has the power to impress and enforce a lien upon that member's shares and dividends. NCUA is interpreting the Federal Credit Union Act to authorize a Federal credit union: (a) to impress a lien at the time the loan is granted, for instance, by noting the existence of the lien in its records at the same time the loan is granted, by reciting in the loan documents that shares and dividends are subject to the lien or are pledged to secure the loan, or by adopting a bylaw or board policy to the same effect; and (b) to enforce the lien by applying the shares and dividends directly to the amount due on the loan without obtaining a court judgment, even if the credit union has allowed the member to make withdrawals and even if a court judgment would be required under state law before a statutory lien could be enforced.

EFFECTIVE DATE: December 16, 1982.

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, Deputy General Counsel, or John L. Culhane, Jr., Senior Attorney, Department of Legal Services, National Credit Union Administration, 1776 G Street, N.W., Washington, D.C. 20456 or telephone: (202) 357-1030.

SUPPLEMENTARY INFORMATION: Section 107(11) of the Federal Credit Union Act states that a Federal credit union "shall have the power . . . 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 U.S.C. 1757(11). Since 1979, NCUA had taken the position that before a Federal credit union could enforce this lien it had to obtain a court judgment on the debt, unless state law would allow the credit union to enforce the lien without going to court; once the credit union were to obtain a court judgment, it could then apply the member's shares to the outstanding loan balance. Credit Manual for Federal Credit Unions 29 (Dec. 1979 ed.).

A credit union trade association and an attorney who represented several credit unions asked NCUA to reconsider this interpretation, noting that it placed a credit union at a disadvantage with respect to any other financial institution, which can usually offset a borrower's loan without going to court. After examining the legislative history of and prior administrative interpretations of the statute, NCUA proposed to interpret section 107(11) of the Federal Credit Union Act to preempt state law and to authorize a credit union to enforce the lien on the shares and dividends of a member by applying those shares and dividends to the outstanding loan balance, as that interpretation appeared to be more consistent with Congressional intent and with the contemporaneous administrative interpretations of the statutory language. 47 Fed. Reg. 44340 (1982).

Comments on the proposed interpretation were submitted by 31 credit unions, 4 state credit union leagues, 2 national credit union trade associations, and 3 attorneys (two of the attorneys represent state credit union leagues, the other attorney represents a number of credit unions). The commentators unanimously supported NCUA's proposed interpretation, although one of the attorneys and one of the trade associations requested that rather than limiting the interpretation to enforcement of the lien in the event of default, NCUA expand the interpretation to discuss when the lien may be impressed and to discuss the consequences of permitting withdrawals. The NCUA Board concurs with these commentators that it would be best to address these related issues in one interpretive ruling and policy statement.

Based on an examination of the legislative history and the contemporaneous administrative interpretations of the statutory language, NCUA believes that Congress intended for the statutory lien to be a "floating" lien. That is, a Federal credit union that has impressed a lien on a member's accounts possesses a lien on those accounts at any time to the extent of the unpaid loan balance together with interest, fees, and other charges. The lien "floats" as outstanding obligations, as well as account balances, vary from time to time. The lien enables a credit union to take priority over other creditors when claims are asserted against a member's accounts. See D. Bridewell, Bridewell on Credit Unions 710 (1942 ed.) (quoting from the May-June, 1940 edition of Cooperative Savings, an official publication of the Farm Credit Administration, the agency then charged with administering the Federal Credit Union Act).

If the credit union evidences its intent to do so, it may impress the lien when the loan is granted. This may be done, for instance, by noting the existence of the lien in the credit union's records at the same time the loan is granted, by reciting in the loan documents that shares and dividends are subject to the lien or are pledged to secure the loan, or by adopting a bylaw or board policy to the same effect. See Credit Manual for Federal Credit Unions 16, 17 (May 1972 ed.); Handbook for Federal Credit Unions 18 (July 1947 ed.). Further, even though the lien has been impressed, the credit union may permit routine withdrawals from a member's account without waiving the statutory lien, even if the withdrawals would reduce the account balance to a level below the outstanding indebtedness.

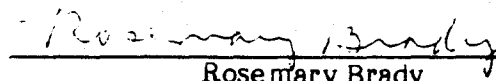
Generally, a credit union may enforce the lien on the shares and dividends of the member by applying those shares to the outstanding indebtedness. Section 107(11) of the Federal Credit Union Act preempts state law; the credit union does not have to obtain a court judgment to enforce the lien, even if a court judgment is usually required under state law before a statutory lien can be enforced. However, if the outstanding indebtedness is the result of extensions of credit under a credit card program, Section 169 of the Truth in Lending Act, 15 U.S.C. 1666h, and Section 226.12(d) of Regulation Z, 12 C.F.R. 226.12(d), will apply; these provisions generally prohibit a Federal credit union from offsetting a borrower's indebtedness arising from a consumer credit transaction under a credit card plan against funds held by the credit union.

Accordingly, the NCUA Board is adopting a final interpretive ruling and policy statement to read as follows.

Interpretive Ruling and Policy Statement (IRPS) 82-5

Section 107(11) of the Federal Credit Union Act states that a Federal credit union "shall have the power . . . 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." If a credit union evidences its intent to do so, it may impress the lien when the loan is granted. This may be done, for instance, by noting the existence of the lien in the credit union's records at the same time the loan is granted, by reciting in the loan documents that shares and dividends are subject to the lien or are pledged to secure the loan, or by adopting a bylaw or board policy to the same effect. The lien dates from the time it is impressed and applies to all of the member's shares outstanding at the time the loan is made. If during the loan term the member's shares are reduced by withdrawal or increased by deposit or dividend payments, the lien will apply to the balance of the same from time to time and may be enforced with respect to any shares in existence at the time of enforcement. The credit union may enforce the lien on the shares and dividends of the member by applying those funds directly to the outstanding indebtedness, which may include the unpaid loan balance together with interest, fees, and other charges. The credit union does not need to obtain a court judgment to enforce the lien, even if a court judgment is usually required under state law before a lien can be enforced.

By the National Credit Union Administration Board, December 11, 1982.



Rosemary Brady
Secretary
National Credit Union Administration Board