



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

February 13, 1991

James E. Forney
Superintendent of Credit Unions
State of Iowa
Department of Commerce
Credit Union Division
East Grand Office Park
200 East Grand, Suite 370
Des Moines, Iowa 50309.

Conflict of Interest
Director

RE: 12 C.F.R. §701.21(c)(8)
(Your Letter of November 21, 1990)

Dear Mr. Forney:

This is in response to your request for a clarification of Section 701.21(c)(8) of the NCUA Rules and Regulations in the context of a particular situation. 12 C.F.R. §701.21(c)(8). A director of a state-chartered, federally-insured credit union has acquired a partial interest in the local credit bureau, which is the only local source of obtaining credit information. The credit union uses the services of the credit bureau. The credit union director allegedly provides no influence on the outcome of the information provided, or in the granting or servicing of any loans made by the credit union.

Based on the above, you asked three questions: First, does the prohibition of the regulation apply? Second, does 'directly or indirectly' refer solely to the collection of a fee, etc., from the borrower paid to the director, et al, by way of the credit union? Third, does the prohibition also apply to compensation from an outside entity, paid to the receiver (director, etc.), in some form of earnings, because the outside activity is in some manner related to the credit union loan activity?

In brief, the answers to your questions are as follows:

(1) Yes, the regulation applies to the scenario described in your letter; (2) No, 'directly or indirectly' refers to more

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than payments from the borrower to the director; and (3) Yes, the regulation applies to payments, in the form of earnings, paid to the covered party.

ANALYSIS

Section 741.3 of the NCUA Rules and Regulations mandates that the requirements of Section 701.21(c)(8) apply to state-chartered, federally-insured credit unions, unless the state regulatory authority adopts substantially equivalent regulations as determined by the NCUA Board. 12 C.F.R. §741.3. We have no record of the State of Iowa requesting a substantial equivalency determination under Section 741.3, as have California, Idaho, Michigan, North Carolina, North Dakota and Texas.

Section 701.21(c)(8) reads:

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....
12 C.F.R. §701.21(c)(8).

As you are aware, the underwriting of loans prudently involves a credit check of the potential borrower. Thus, as long as the director has an interest in the local credit bureau, any extension of credit by the credit union based on the credit check involves a potential conflict of interest. Section 701.21(c)(8) is intended to ensure that decisions made by a federally-insured credit union at the various stages of making a loan will not be influenced by the receipt of things of value by credit union officials involved in the lending process. The regulation prohibits direct as well as indirect payments in order to avert form of payment being the determinative factor in a violation of the regulation. Creative insider abuses of this type have resulted in substantial losses to the National Credit Union Share Insurance Fund.

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The language of the regulation is broad, and may result in the restriction of activities, such as in the scenario you describe, where it appears that no insider abuse is involved. However, we believe that the language of the regulation continues to be necessary to protect against insider abuse. We would advise that either the director should resign his position, or that the credit union should use the services of another credit bureau to avoid any potential conflicts of interest and violation of the regulation.

Sincerely,



Hattie M. Ulan
Associate General Counsel

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