



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

June 5, 1991

Glenn W. Barstch,
Branch Manager
Lederle Employees Federal Credit Union
401 N. Middletown Road
Pearl River, New York 10965-1299

Re: Mortgage Servicing by Third Party
(Your March 27, 1991 Letter)

Dear Mr. Barstch:

You asked for our opinion regarding Article VII, Section 5(j) of a document that you identify as Lederle Employees Federal Credit Union's ("Lederle") charter, and its effect upon a proposed "Agent and Servicing Agreement" between Lederle and Credit Union Central Mortgage Corporation ("CUCMC"). We are unable to determine your precise question from your letter; however, your attorney's opinion raises the issue of whether a federal credit union ("FCU") has authority to contract with a third party who will "handle or service mortgage loans" for the FCU, and we assume that is the question to which you wish us to respond. An FCU does have such authority. Please note that this letter addresses only that specific issue.

Your letter provides very few facts regarding the proposed agreement. It appears to us, based on your letter and your attorney's opinion letter, that Lederle and CUCMC plan to enter into a contract whereby CUCMC will process and/or service mortgage loans made by Lederle, and grant mortgage loans to individuals referred by Lederle. Both arrangements are permissible for FCUs, as explained below.

Your attorney's opinion also alludes to CUCMC acting as Lederle's agent in actually making mortgage loans for Lederle. An FCU cannot completely delegate to a third party the authority to make mortgage loans, and retain its position as lender. It can refer its members to a third party lender

FOIA VOL II ID
VOL I, A, 6

Glenn W. Barstch, Branch Manager
June 5, 1991
Page 2

who will make the loans; the third party, not the FCU, is the lender in such a case.

Processing and/or Servicing of Mortgage Loans by CUCMC

While there is no specific power for an FCU to engage a third party to process or service its mortgage loans, Section 107(17) of the Act, 12 U.S.C. §1757(17), allows an FCU "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." In Arnold Tours v. Camp, 472 F.2d 427 (1st Cir. 1971), the court defined an "incidental power" for national banks as:

[an activity] that is convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act. If this connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power.

The "convenient or useful" test of incidental powers was applied to FCUs in American Bankers Association v. Connell, 447 F. Supp. 296 (D.D.C. 1978).

Section 107(5)(A) of the Federal Credit Union Act (the "Act"), 12 U.S.C. §1757(5)(A) and Sections 701.21 (f) and (g) of NCUA's Rule and Regulations (the "Regulations"), 12 C.F.R. §701.21 (f) and (g) expressly authorize an FCU to grant mortgage loans to its members. Moreover, Section 107(1) of the Act, 12 U.S.C. §1757(1), gives an FCU the power to enter into contracts. In our view, contracting with a third party for processing and/or servicing of mortgage loans is a convenient or useful activity in connection with an FCU's exercise of its express power to grant mortgage loans. For that reason, we believe that the proposed processing/servicing arrangement is within Lederle's incidental powers.

Although you do not state whether any FCUs have invested in or loaned to CUCMC, thereby making it a credit union service organization ("CUSO") for purposes of the Act and Regulations, we point out that Section 701.27(d)(5)(i) of the Regulations, 12 C.F.R. §701.27(d)(5)(i), permits a CUSO to

Glenn W. Barstch, Branch Manager
June 5, 1991
Page 2

who will make the loans; the third party, not the FCU, is the lender in such a case.

Processing and/or Servicing of Mortgage Loans by CUCMC

While there is no specific power for an FCU to engage a third party to process or service its mortgage loans, Section 107(17) of the Act, 12 U.S.C. §1757(17), allows an FCU "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." In Arnold Tours v. Camp, 472 F.2d 427 (1st Cir. 1971), the court defined an "incidental power" for national banks as:

[an activity] that is convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act. If this connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power.

The "convenient or useful" test of incidental powers was applied to FCUs in American Bankers Association v. Connell, 447 F. Supp. 296 (D.D.C. 1978).

Section 107(5)(A) of the Federal Credit Union Act (the "Act"), 12 U.S.C. §1757(5)(A) and Sections 701.21 (f) and (g) of NCUA's Rule and Regulations (the "Regulations"), 12 C.F.R. §701.21 (f) and (g) expressly authorize an FCU to grant mortgage loans to its members. Moreover, Section 107(1) of the Act, 12 U.S.C. §1757(1), gives an FCU the power to enter into contracts. In our view, contracting with a third party for processing and/or servicing of mortgage loans is a convenient or useful activity in connection with an FCU's exercise of its express power to grant mortgage loans. For that reason, we believe that the proposed processing/servicing arrangement is within Lederle's incidental powers.

Although you do not state whether any FCUs have invested in or loaned to CUCMC, thereby making it a credit union service organization ("CUSO") for purposes of the Act and Regulations, we point out that Section 701.27(d)(5)(i) of the Regulations, 12 C.F.R. §701.27(d)(5)(i), permits a CUSO to

Glenn W. Barstch, Branch Manager

June 5, 1991
Page 3

engage in "consumer mortgage loan origination; [and] loan processing, servicing and sales." If CUCMC does qualify as a CUSO, any FCUs investing in or loaning to CUCMC must comply with all of the provisions of Section 701.27. However, it is not necessary that CUCMC qualify as a CUSO under the Regulations in order for Lederle to contract with CUCMC for mortgage processing and/or servicing.

Referring Members to CUCMC for Mortgage Loans

Part 721 of the Regulations, 12 C.F.R. Part 721, permits an FCU to engage in group purchasing activities for the benefit of its members. While Part 721 does not specifically mention FCU use of third party mortgage lenders, it does cover that situation. Prior to September, 1984, NCUA had a regulation, Section 701.21-6, which governed FCU involvement with third party mortgage lenders. The purpose of that regulation was to enable FCUs that otherwise would be unable to make mortgage loans available to their members, to do so through use of third party lenders. That regulation was eliminated in 1984, at which time the NCUA Board stated that FCU involvement with third party mortgage lenders would henceforward be governed by Part 721. (See, 49 Fed. Reg. 30685, August 1, 1984.)

Under Section 721.1, an FCU may make the services of a third-party vendor, in this case, CUCMC, available to its members, may endorse the vendor, and may perform administrative services on behalf of the vendor. Section 721.2(b)(3) provides that the FCU may be compensated for the "cost amount" incurred in performing such services for the vendor. Section 721.2(a)(2) states:

"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.

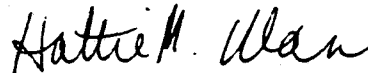
Lederle may refer members who desire mortgage loans to CUCMC, and may be reimbursed by CUCMC for the actual cost incurred in taking loan applications or otherwise performing administrative functions associated with the referrals. However, in

Glenn W. Barstch, Branch Manager
June 5, 1991
Page 4

this situation, CUCMC is the lender. Lederle cannot completely delegate its lending authority to CUCMC and allow CUCMC to make FCU mortgage loans. The Act provides that "management of a Federal credit union shall be by a board of directors, a supervisory committee, and where the bylaws so provide, a credit committee." 12 U.S.C. §1761(a). The Act also sets forth a detailed statutory structure and specific powers relating to establishment of loan criteria, 12 U.S.C. 1757(5)(A); review of applications, 12 U.S.C. §1761c(a); approval and disapproval, 12 U.S.C. §1761b(1), §1761c(a); and appeals of loan disapprovals, 12 U.S.C. §1761c(b). In view of this statutory scheme, we have consistently interpreted the Act to prohibit total delegation by FCU management of loan decisionmaking, particularly to persons other than the credit committee and loan officers.

You also ask whether there is anything you are overlooking regarding the proposed agreement with CUCMC. We note that you did not include a copy of the agreement with your letter, and therefore we have no way of knowing whether it contains other provisions of concern. In any event, it is our policy not to review contracts on behalf of credit unions. The appropriate course of action for an FCU contemplating a contract is to obtain an opinion from local counsel, as Lederle did in this case. In the event that Lederle's attorney has further specific questions regarding the Act or Regulations, he may contact this Office for guidance.

Sincerely,



Hattie M. Ulan
Associate General Counsel

GC/MRS:sg
SSIC 3600
91-0406