NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

November 4, 1991

Cary C. Boyden, Esq.
Pillsbury, Madison & Sutro
455 Capitol Mall
Suite 335
Sacramento, California 95814

Re: Proposed Automobile Leasing Program
(Your Letter of May 9, 1991)

Dear Mr. Boyden:

You have requested an opinion regarding a proposed automobile leasing program for credit unions (the "Program") by your client, a vehicle lessor (the "Lessor"). In particular you desired confirmation of your analysis that the Program complies with NCUA Interpretive Ruling and Policy Statement No. 83-3, Federal Credit Union ("FCU") Leasing of Personal Property to Members ("IRPS 83-3"). For the reasons discussed in this letter, the Program does not comply with IRPS 83-3. Neither does the Program expressly comply with Regulation M under the Consumer Leasing Act nor Regulation B under the Equal Credit Opportunity Act. Certain clarifications and representations are also requested. We suggest that you advise your client to adapt the Program to the requirements in this letter if it is to be marketed to FCUs.

BACKGROUND

You represented that the Program has the following features:

1. Members (individually a "Member") of participating FCUs interested in leasing new cars will be directed to the Lessor by the FCU.

(New Category Reg M - Consumer Lease

2. The Lessor will procure and process the Member's lease (credit) application and transmit the credit package to the FCU.

3. The FCU will review the package and, if approved, advise the Member and the Lessor. Compliance with Equal Credit Opportunity Act notice requirements will be effected by the FCU.

4. Assuming approval, the Lessor will order the car and deliver it to the Member upon the Member's execution of the lease and the Lessor's procurement of any related documents. The actual lease used will, in all cases, be in compliance with the full payout provisions of IRPS 83-3, including the related residual risk limitations thereof. For these purposes, where necessary because of the amount of the residual, the Lessor's recourse balloon payment liability will be considered together with the sinking fund discussed [in paragraph 9] below.

5. The vehicle will be titled with the Lessor as the registered owner and the FCU as the sole lienholder.

6. Following receipt of the lease package and the FCU's loan documents from the Lessor, the FCU will advance to the delivering dealer the cost of the car and will advance separately to the Lessor the Lessor's fee, a portion of which will be deposited into an account in which the FCU has a security interest securing the FCU's receipt of any amounts owed in connection with the transaction. In certain cases a separate buying service may be involved in which case a third check will be issued to that entity for its fee. The loan documents will be non-recourse except as discussed below and, accordingly, will provide the FCU with a security interest in the lease and vehicle and, further, state that the FCU's recourse on account of the Member's default will be solely against the Member in accordance with the lease.

7. During the lease term the FCU will bill and collect lease payments as well as service the lease in all respects, except that the Lessor will be responsible to obtain whatever liability insurance the Lessor believes appropriate to protect the Lessor's tort risk.

8. Upon early termination of the lease, whether voluntary or involuntary, by purchase, voluntary surrender or following a default, the FCU will be entitled to foreclose its security interest. Then the FCU will dispose of the vehicle, receive the proceeds of disposition from sale to the Member or other disposition of the vehicle (up to the amount of the balance of the loan to the Lessor), effectuate the transfer of title and seek collection of any deficiency. Again, because the loan is non-recourse except at lease expiration, the FCU will look solely to the proceeds of sale and then to the Member for collection of any deficiency amounts due. The Lessor will have no liability for any deficiency amount flowing from a Member default.

9. Upon lease expiration, the vehicle will be purchased or returned. If purchased, the sales price will equal the loan balance plus a purchase option fee. The Member will pay this entire amount to the FCU which will remit back to the Lessor any purchase fee. If the vehicle is returned, the Lessor will sell the unit and provide the proceeds of sale to the FCU. Any deficiency will be the recourse liability of the Lessor, and there will be a sinking fund to secure that obligation. See Your Letter of May 9, 1991, pp. 1-2.

ANALYSIS

Leasing Issues

IRPS 83-3 provides as follows:

> FCUs 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. FCUs shall retain salvage powers over the leased property. FCUs are not subject to the usury ceiling while engaging in lease financing. FCUs engaging

> in leasing must maintain a contingent liability insurance policy with an endorsement for leasing. IRPS 83-3, 48 Fed. Reg. 52568, 52569 (Nov. 21, 1983) (For purposes of convenience, all references to IRPS 83-3 are to the enclosed copy of IRPS 83-3 adopted by the NCUA Board on November 10, 1983. The quoted language appears on p. 7).

We note that the supplementary information section of IRPS 83-3 refers to the FCU as the lessor. Your Program involves a third party lessor although you state in your letter that the lease must involve an obligation of an FCU member rather than a third party nonmember. We will identify which party we are discussing in brackets [FCU or third party] when we use the term lessor. For purposes of our analysis, we address the critical elements for FCU leasing from IRPS 83-3 where we perceive a problem with your Program.

1. A lease: "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." IRPS 83-3, p. 2. The leading case in this area, upon which IRPS 83-3 is extensively patterned, states that:

> [Leasing is permitted] when, in the light of all relevant circumstances, the transactions constitute the loan of money secured by the properties leased. A transaction may be so characterized, in our opinion, even if it is designed so that the lessor bank does not recover during the initial lease term every penny of the cost of the leased property plus its financing costs. A lease ceases to be a secured loan when the lessor assumes material burdens other than those of a lender of money and is subject to significant risks not ordinarily incident to a secured loan. M & M Leasing Corp. v. Seattle First Nat. Bank, 563 F.2d 1377, 1380 (9th Cir. 1977), cert. denied 436 U.S. 956 (1978) ("M & M Leasing") (Seminal case allowing national banks to enter leasing business).

Therefore, in order to be a permissible lease, FCU leases must comply with relevant NCUA lending rules and regulations, such as Section 701.21, and not be subject to additional risks not incident to a secured loan. For example, in accord with Section 701.21, any FCU leasing personal property to members must have a written policy regarding their leasing program, retain completed leasing applications, limit maturities to no more than 12 years, and, for business leases, follow the member business loan requirements. 12 C.F.R. §701.21. The sole exception to this statement is the usury limitation. As stated in IRPS 83-3, FCU's are not subject to the usury ceiling when engaging in lease financing. The Program is deficient in that no representations are made regarding compliance with applicable NCUA lending regulations.

In M & M Leasing the ability of national banks to engage in traditional motor vehicle leasing was in issue. The court described this business as follows:

> Motor vehicle leases usually, but not invariably, are generated by automobile dealers. Particular dealers will enter into an agreement with a bank under which dealers will lease automobiles to their customers. The major terms of a lease, i.e., make, model, accessories, term, and payment schedule, are fashioned by the dealer in a manner that fits his and the customer's interests and conforms to the lease design envisioned by the dealer's arrangement with the bank. To protect itself against improvident leases the bank possesses the right to review both the substantive terms of a lease and the creditworthiness of the lessee before accepting the lease. The crucial items reviewed are the credit rating of the customer and the vehicle's residual value. Upon accepting the lease the lessee-customer is notified and instructed to make lease payments to the bank. The title of the vehicle shows the bank as the legal owner, while the customer is listed as registered owner and lessee. Customers who approach the bank initially are usually referred to dealers with whom the bank has leasing arrangements. M & M Leasing at 1380.

This is the type of leasing activity envisioned by IRPS 83-3. The Program is much different from the type of leasing contemplated in IRPS 83-3. As a matter of fact, the Program sounds close to activity specifically prohibited by the court in M & M Leasing:

> It should be clear that our holding is not without limits. It does not embrace the view that national banks may compete with appellants [leasing companies] in the daily or short-term car rental business. Nor does it permit national banks to become self-financing automobile dealers, utilizing their unique position to acquire an inventory of automobiles at advantageous prices to lease at going market rates to customers. Neither activity is a means by which a bank makes a 'loan of money on personal security.' Each is a business distinct from banking. M & M Leasing at 1383 (emphasis added).

The Program, with its referral of members to a "Lessor" [third party] who arranges provision of an automobile, arguable financing of the nonmember "Lessor" instead of a member, and lack of adequate security for the FCU (matters discussed elsewhere in this opinion) indicate to us that the Program is not a lease envisioned or permitted by IRPS 83-3 in its present form.

2. To members: The "Lessor" [third party] is not a member of the leasing FCU. In your request letter you state that the FCU makes "the loan to the Lessor [third party]...." See Your Letter of May 9, 1991, paragraph 8, p. 2. FCUs are not permitted to loan money or lease personal property to nonmembers. The representation that a member executes a lease does not change this analysis, since the actual obligor seems to be the "Lessor." The leasing obligation must clearly and unequivocally be that of a member in order for an FCU to engage in the transaction. IRPS 83-3 has never been

interpreted to permit FCUs to finance nonmember lessors, as you request in your letter.

3. Direct or indirect lease: "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." IRPS 83-3, pp. 4-5.

It seems that the Program contemplates an indirect lease. However, the FCU is not the owner of the leased property under the Program. You cited a prior opinion by this office in which, limited to a narrow fact pattern, an FCU was permitted to engage in a leasing program without taking ownership of the leased property. That opinion was premised on the inability of an FCU in that particular state to be licensed as a motor vehicle dealer, as required for motor vehicle lessors under state law, coupled with bond posting and other onerous state requirements. These are facts that you have failed to show in your request. Only in such circumstances has the NCUA permitted FCUs to protect their security in the leased property by having the leasing company assign all of its rights in the lease to the FCU, naming the FCU as sole lienholder on all leased motor vehicles and having the leasing company execute an unconditional power of attorney to the FCU allowing the FCU to transfer title without notice to the leasing company. In all other circumstances, the FCU must take sole title directly to any leased property. Information available to NCUA indicates that in most states FCUs can easily take title in their own name, and in only a few states will FCUs be forced to undergo the more cumbersome procedures (including an unconditional power of attorney) permitted by the prior opinion to secure themselves. In order for the Program to use these procedures, a legal opinion addressing obstacles to the FCU titling the leased property in its own name must, to NCUA's satisfaction, demonstrate the need for the title to be held by a party other than the FCU. For the NCUA to hold otherwise would be to allow an impermissible risk. As the court in M & M Leasing states:

> Finally, our holding manifestly is not intended to authorize leases which impose significant financial

> risks on national banks more onerous than those incident to loans. Therefore, it is necessary that the lessor bank look primarily to the obligations of the lessee for the entire return of its advances. It is the lessee's creditworthiness, not primarily the market value of the leased property, to which the bank must look for its return. No banker, however, ignores the borrower's collateral; nor must he when the loan is cast in lease form. M & M Leasing at 1383-84 (emphasis added).

4. Net lease: "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." IRPS 83-3, p. 3.

The court in M & M Leasing clarifies this requirement:

> [M]otor vehicle leases... provide that the burdens of operating costs and risks are borne by the lessee. Thus, the lessee agrees to purchase insurance sufficient to cover the bank's interest, to pay all repairs and maintenance, and to assume the risk of loss or damage. M & M Leasing at 1381.
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> It is also clear that national banks cannot provide operational services such as repairs, maintenance, spare parts, insurance coverage, license renewals, etc. Such services are not those of a bank. This proscription shapes the duration of a lease that a national bank properly can employ. Short term leases which inescapably thrust upon the bank significant service responsibilities impose non-banking responsibilities. As previously indicated, leases of automobiles for two or three years do not necessarily entail nonbanking responsi bilities; and, of course, a lease for the economic
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> life of the property also does not. M & M Leasing at 1383.

Under the Program, you state that the FCU "will service the lease in all respects." See Your Letter of May 9, 1991, paragraph 7, p. 2. It is unclear exactly what is meant by this phrase. In order for it to comply with IRPS 83-3 it must not include any of the prohibited services mentioned in the IRPS or M & M Leasing. Further clarification is needed on this point.

5. Full payout: "The full payout requirement means that over the term of the lease the lessor [FCU] must recoup its entire investment in the leased property plus the cost of the financing. The lessor's [FCU'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." IRPS 83-3, p. 3.

You represent that the Program will be in compliance with the full payout provisions of IRPS 83-3. See Your Letter of May 9, 1991, paragraph 4, p. 1. However, you intimate with a discussion of expected deficiencies that it is not a full payout lease. See Your Letter of May 9, 1991, paragraph 8, p. 2. Further clarification is needed on this issue and the method by which this requirement will be met in context of the Program.

6. With a maximum limit of 25 percent residual value, unless guaranteed: "In M & M Leasing... 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." IRPS 83-3, pp. 3-4.

Again, you represent that the Program will be in compliance with the full payout provisions of IRPS 83-3, "including the related residual risk limitations thereof". See Your Letter of May 9, 1991, paragraph 4, p. 1. However, you indicate with a discussion of expected deficiencies that the residual value requirement may not be met. See Your Letter of May 9, 1991, paragraph 8, p.2. Further clarification is needed on this issue and the method by which this requirement will be met in context of the Program.

7. In-force contingent liability insurance policy with an endorsement for leasing: "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." IRPS 83-3, p. 5.

It is nowhere represented that this requirement will be met under the Program. This deficiency must be corrected in order for the Program to comply with IRPS 83-3. We note in your description of the Program (see Your Letter of May 8, 1991, paragraph 7, p. 2) that the Lessor [third party] will be responsible for obtaining appropriate insurance. This does not satisfy the IRPS 83-3 requirement that the FCU obtain contingent liability coverage.

8. Salvage powers: "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." IRPS 83-3, pp. 5-6. M & M Leasing also discusses the disposition of collateral in bank leasing.

> Thus, at the lease's end the lessor bank will dispose of the property in the simplest possible manner. Should the lessee not purchase the item, either for the estimated residual value or for a mutually agreeable price, the lessor bank will dispose of it by sale or by way of a new lease. Motor vehicles not sold to the lessee, for example, are either resold to the dealer, sold in the wholesale market, or leased to another customer. M & M Leasing at 1381.
>
> Proscribed operational services, also, do not include the functions incident to the disposal of the property at the expiration of the lease as described [in this opinion]. So long as these activities constitute only the orderly liquidation of the bank's security they remain within the business of banking. M & M Leasing at 1383.

No representation is made regarding the availability of these salvage powers to an FCU engaged in leasing under the Program. In light of our discussion regarding the ownership of the collateral and titling requirements in Section 4 of this Leasing Issues analysis, the Program must be recast in order to comply with this element of IRPS 83-3. Both interim and end-of-lease salvage powers of the FCU must be addressed.

Consumer Law Issues

The only consumer issue contemplated in your request is the provision of Equal Credit Opportunity Act notice require-

ments. See Your Letter of May 9, 1991, paragraph 3, p. 1. The NCUA requires compliance with Regulation M regarding consumer leasing as well as Regulation B regarding equal credit opportunity.

Regulation M of the Federal Reserve Board, which implements the Consumer Leasing Act, is enforced by the NCUA for FCUs. 15 U.S.C. 1667, 12 C.F.R. Part 213, Appendix D. Regulation M applies exclusively to consumer leases:

> for the use of personal property by a natural person primarily for personal, family or household purposes, for a period of time exceeding four months, for a total contractual obligation not exceeding $25,000, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease. 12 C.F.R. §213.2(a)(6).

The required disclosures for consumer leases include a description of: the leased property; payment terms and amounts; insurance required; any warranties; the parties responsible for servicing the property; the security interest; penalties for late payments or default; any option to purchase; conditions of termination; the value of the property; and the lessee's liability. 12 C.F.R. §213.4(g)(1-15).

The Regulation M disclosures must be made clearly, conspicuously and in a meaningful sequence, with numerical amounts and percentages stated in figures and printed in certain prescribed sizes. 12 C.F.R. §213.4(a)(1). Disclosures must be made prior to the consummation of the lease on a dated written statement identifying the lessor and lessee either on the lease contract or on a separate statement, with a copy given to the lessee. 12 C.F.R. §213.4(a)(2). Except in Puerto Rico where they must also be provided in Spanish, the disclosures must be in English. 12 C.F.R. §213.4(a)(4).

Lessors are responsible for making the required Regulation M disclosures. 12 C.F.R. §213.4(a)(1). "Lessor" is defined as "a person who, in the ordinary course of business regularly leases, offers to lease, or arranges for the leasing of personal property under a consumer lease." 12 C.F.R.

§213.2(a)(8). It appears that in direct leasing, the FCU would be the lessor for purposes of Regulation M disclosures; for indirect leasing it would be the third party lessor since Regulation M disclosures are made prior to consummation of the lease. It would seem that the third party lessor and not the FCU would be the lessor for purposes of Regulation M under the Program. However, this is not entirely clear from your request, nor does your request contain any representations or discussion regarding Regulation M. Therefore, some representation of compliance with Regulation M by the lessor should be made, and further information is requested on which party is the lessor for Regulation M purposes.

Regulation B of the Federal Reserve Board, which implements the Equal Credit Opportunity Act, is enforced by the NCUA for FCUs. 15 U.S.C. §1691-1691f, 12 C.F.R. Part 202, Appendix A. Regulation B provides that "[a] creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction." 12 C.F.R. §202.4.

The Ninth Circuit Court of Appeals held that the Equal Credit Opportunity Act and Regulation B also apply to consumer leases in Brothers v. First Leasing, 724 F.2d 789 (9th Cir. 1984), cert. denied, 469 U.S. 832 (1984). It would seem that compliance with Regulation B would be incumbent upon the lessor under the Program. You state that the FCU would make these disclosures. Further clarification is requested regarding which party must comply with Regulation B, and how such compliance is to be achieved.

In addition, assuming the Program will eventually comply with IRPS 83-3, our analysis should not be construed as recommending the Program for FCUs. Before participating in the Program, an FCU should review all documents pertaining to the Program to determine their responsibilities and obligations. An FCU should also satisfy itself that the leasing company they are dealing with is in a sound financial position. Furthermore, even if the Program is modified in accordance with this opinion, the NCUA reserves its right to review the Program on safety and soundness grounds.

Once you have addressed the points of concern discussed in this opinion you may resubmit it for a second review for compliance with IRPS 83-3 and other NCUA Rules and Regulations.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

GC/MEC:sg
SSIC 3800
91-0513

Enclosure

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 determinied 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