

March 27, 1996
James M. Rockett, Esq.
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Three Embarcadero Center
San Francisco, CA 94111-4066

Re: Percentage Lease Arrangements for Federal Credit Unions
(Your Letter of February 29, 1996)

Dear Mr. Rockett:

You represent a registered broker-dealer that enters into networking arrangements with financial institutions, including federal credit unions (FCUs), to market non deposit investment products. One arrangement involves your client leasing a portion of the premises of a financial institution in exchange for payments based on a percentage of the gross revenue derived by your client from the sale of products through the institution. You note that percentage lease arrangements have been approved by the federal bank and securities regulatory agencies and ask whether they are permissible for FCUs.

You point to the rationale used by the Office of the Comptroller of the Currency (OCC) in approving percentage leases for national banks. It appears that national banks have the express power to lease excess office space to others, including lobby space, and that the OCC concluded that incidental to that power was the authority to establish usual and customary lease terms, including the receipt of rent based on a percentage of the lessor's volume of sales or gross income from the rented space. You note that FCUs have been limited in their ability to enter into direct networking relationships with broker-dealers due to the restrictions of Part 721 of the NCUA Rules and Regulations, 12 C.F.R. Part 721.

Section 721.2(b) provides that for group purchasing plans involving, for example, the sale of non deposit investment products, an FCU may be reimbursed by a vendor for administrative functions performed on behalf of the vendor in an amount not exceeding the cost amount. Section 721.2(a)(2) defines cost amount as the total of the direct and indirect costs to the FCU of those administrative functions. Section 5200.6 of the NCUA *Accounting Manual for Federal Credit Unions* (enclosed) addresses direct and indirect costs for group purchasing activities. It states, in part, as follows:

[D]irect expenses are costs that apply to a specific service, department, operation, segment or unit of output within a credit union. These are sometimes referred to as traceable, specific, or separable costs. For example, salaries of credit union employees assigned to insurance or group purchasing activities would be considered direct costs. Indirect or allocated costs are incurred as part of an entire building, section, or division, and allocated within the respective service, subdivision, or subsection. They cannot be traced to individual departments, operations, segments or units of output. For example, costs for building depreciation, rent, insurance, electricity and etc., are indirect costs. Indirect costs are often referred to as nontraceable, common, general, or joint costs.

While the scope of "direct and indirect costs" can be quite broad, encompassing utilities and insurance, it is not flexible enough to permit the tying of such costs to the volume of business done by a vendor. Direct costs to a credit union of leasing space to a vendor to sell non deposit investment products may vary somewhat, depending on volume, but indirect costs, which will likely constitute the bulk of any reimbursement, will be fairly constant. Accordingly, as you surmised, an FCU may not enter into a percentage lease arrangement with a broker-dealer.

Although Part 721 limits the reimbursement an FCU may receive for administrative functions performed on behalf of a vendor, it is the only method by which an FCU can make available to its members the products or services of a vendor. Contrary to the policy regarding national banks, FCUs do not have express authority to lease office space to others. FCUs are expected to purchase or lease office space only for their own use. NCUA has long maintained that FCUs are not in the business of leasing space, although temporary leasing of unused space is occasionally permitted on a case-by-case basis. These policies are reflected in Section 701.36 of the NCUA Rules and Regulations, 12 C.F.R. §701.36(d), governing FCU ownership of fixed assets. Pursuant to Part 721, an FCU may make a group purchasing plan available to its members on the theory that it is not engaging in the particular activity or business, but is simply providing informational or goodwill services to its members and receiving reimbursement for the cost of its involvement.

Sincerely,

Richard S. Schulman
Associate General Counsel

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Enclosure