

November 22, 1996

Keith O'Gorman  
Burns, O'Gorman, Black and Weyand, L.L.C.  
750 Rittiman Road  
San Antonio, Texas 78209-5596

Re: Retail Installment Contracts (Your September 13, 1996, Letter)

Dear Mr. O'Gorman:

You have asked whether credit unions must comply with the terms contained in the retail installment contracts that they purchase from motor vehicle dealers. Your concern is that the retail installment contracts provide for the deduction of a \$25.00 "acquisition cost" upon prepayment of the contract obligation, and you want our opinion as to whether a credit union should comply with these terms. Our response only covers federally chartered credit unions ("FCU"). You should also direct this question to the appropriate state credit union authority for federally insured state chartered credit unions.

#### ANALYSIS

A FCU may purchase the eligible obligations of its members, which includes retail installment contracts. However, the obligations purchased must be (1) "loans it is empowered to grant," or (2) "refinanced with the consent of the borrowers, within 60 days after they are purchased." 12 C.F.R. §701.23(b)(i). There are several limitations placed on FCU loans to members, such as, maturity limits, interest rate limits, and a loan cannot impose a penalty for prepayment. 12 C.F.R. §701.21(c). If the terms contained in a retail installment contract conflict with the lending rules set out in the FCU Act or the NCUA Rules and Regulations, the FCU cannot purchase the contract unless it plans to refinance the contract so that the terms are consistent with the lending rules.

In Texas, Articles 5069-7.01 through 5069-7.10 of the Texas Revised Civil Statutes Annotated govern retail installment contracts. You state that a number of the retail installment contracts purchased by the credit unions you represent contain language identical to that in Article 5069-7.04(2), "Refunds on Prepayment," which provides, in part, that upon prepayment "the amount of the refund credit shall represent at least as great a proportion of the finance charge, after first deducting therefrom an acquisition cost of Twenty-five Dollars." TEX. REV. CIV. STAT. ANN. art. 5069-7.04(2) (West 1987) (emphasis added).

Under the FCU Act, "a borrower may repay his loan, prior to maturity in whole or in part on any business day without penalty...." 12 U.S.C. 107(5)(A)(viii). The mere fact that a cost is imposed at prepayment does not make it a prepayment penalty. However, the proper test for determining whether a cost is a prepayment penalty is to ascertain whether the cost, imposed at the time of prepayment, would not be imposed if the loan was paid at maturity; the amount is not determinative. Goldman v. First Federal Savings and Loan Association of Wilmette, 518 F. 2d 1247 (1975).

In this instance the \$25.00 acquisition cost constitutes a prepayment penalty. All indications are that under the terms of the retail installment contracts, the \$25.00 acquisition cost would not be deducted if the obligation was paid at maturity. Further, you state that the collection of the \$25.00 acquisition cost could generate significant income for some credit unions. This statement implies that the \$25.00 acquisition cost is an expense only imposed at prepayment.

Since the FCU Act and NCUA's Regulations prohibit the imposition of any penalty for the early payment of

a loan, a FCU cannot in turn purchase a retail installment contract containing a prepayment penalty unless the contract obligation is refinanced by the FCU within 60 days of its purchase or the prepayment penalty is excluded from the contract prior to purchase.

Sincerely,

Michael J. McKenna  
Acting Associate General Counsel

GC/NSW:bhs  
SSIC 3600  
96-0922

cc: Region V