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## National Credit Union Administration

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August 10, 2015

Mr. Mike Mercer, President/CEO  
Georgia Credit Union Affiliates  
6705 Sugarloaf Parkway, Suite 200  
Duluth, GA 30097

Dear Mr. Mercer:

RE: Loan Participations in Indirect Loans –  
Originating Lender

You have asked if a federally insured credit union (FICU) is permitted under NCUA's loan participation rule<sup>1</sup> to purchase a participation in a loan generated by an indirect lending arrangement. You also have asked if a FICU or other "eligible organization," permitted by regulation to be part of a loan participation,<sup>2</sup> that is the seller of a participation, may be considered the "originating lender" where the seller has generated the loan by an indirect lending arrangement with a retailer. The answer to both questions is yes, but only under the limited circumstances discussed below.

A typical indirect lending arrangement with a loan participation component is as follows. A retailer, often an auto dealer, initially enters into a sales contract with a borrower at the point of sale. Concurrently with or subsequent to contracting with the borrower, the retailer assigns the sales contract to a FICU or other eligible organization (lead lender), which funds and holds a security interest in the loan.<sup>3</sup> Another FICU or eligible organization then purchases a participation interest in the loan from the lead lender.<sup>4</sup>

NCUA's loan participation rule allows a FICU to purchase a loan participation interest only from the lender that initially originated the loan. The rule states that a participation agreement must be made with the "originating lender," which is defined by the loan participation rule as the "participant with which the borrower initially or originally contracts for a loan and who, thereafter or concurrently with the funding of the loan, sells participations to other lenders."<sup>5</sup> Thus, under a narrow reading of the rule, only the lender that initially or originally contracts with the borrower for a loan may qualify as the "originating lender" for the purpose of selling participations in that loan.

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<sup>1</sup> 12 C.F.R. §701.22; 78 FR 37946 (Jun. 25, 2013).

<sup>2</sup> "Eligible organization" means a credit union, credit union organization, or financial organization. "Financial organization" means any federally chartered or federally insured financial institution; and any state or federal government agency and its subdivisions. 12 C.F.R. §701.22(a).

<sup>3</sup> We understand that the term "indirect lending" as commonly used in the credit union industry may or may not be commonly used in the industries of the other eligible organizations involved in a loan participation arrangement such as a bank, for example.

<sup>4</sup> Under NCUA's loan participation regulation, a "lead lender" is not necessarily an "originating lender."

<sup>5</sup> 12 C.F.R. §701.22(a).

In the indirect lending arrangement described above, the participant with which the borrower initially or originally contracts for the auto loan is the auto dealer at the point of sale. Therefore, a narrow reading of the rule generally precludes a FICU from purchasing a participation in a loan from a lead lender that generated the loan through an indirect lending arrangement with a point of sale retailer because the lead lender is technically not the originating lender (i.e., the participant with which the borrower initially or originally contracts for a loan.) In that context, the point of sale retailer typically is the party with whom the borrower initially or originally contracts for a loan. A point of sale retailer such as an auto dealer, however, does not qualify as an “eligible organization” that is permitted to be a part of a loan participation under the loan participation rule, rendering the participation impermissible.<sup>6</sup>

However, we believe that a broader reading of the rule with respect to the definition of “originating lender” is appropriate in this instance. Loan participations are a valuable tool for credit unions to manage liquidity and to diversify their loan portfolios. Loan participations also help credit unions better serve their members’ needs. The definition of “originating lender” in the current loan participation rule was purposefully crafted narrowly to encourage underwriting discipline and to add an additional measure of safety and soundness to the loan participation process. The definition was not intended, however, to be an obstacle to FICUs’ ability to engage in advantageous indirect lending arrangements and to subsequently participate out loans resulting from those arrangements. Accordingly, we believe that where a loan participation involves an indirect lending arrangement and the following limiting conditions exist, then a broader reading of the definition of “originating lender” is warranted.

Specifically, this broader reading is appropriate where a retailer is acting as an agent of a FICU or other eligible organization, and is simply performing as an administrative functionary processing a loan for a FICU or other eligible organization and where the retailer’s activities are part and parcel of, and an extension of, the FICU’s or eligible organization’s lending operations. In this context, the retailer is not acting as a separate lender generating loans for itself and then selling those loans to a FICU or other eligible organization. Rather, the retailer is a facilitator that is part of the FICU’s or eligible organization’s loan processing mechanism, and the FICU or eligible organization is the de facto originating lender, and, therefore, the originating lender for purposes of the loan participation rule.<sup>7</sup>

NCUA’s treatment of indirect loans under its eligible obligations rule,<sup>8</sup> which is applicable to federal credit unions (FCU), is instructive in this regard. Under the eligible obligations rule, an FCU may be involved in an indirect lending arrangement under its authority to make loans to its members, rather

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<sup>6</sup> Id.

<sup>7</sup> We note that the requirement that purchasing FICUs only participate with the “originating lender” derives from the FCU Act’s requirement for originating FCUs to retain at least a 10 percent interest in the face amount of all loans they participate out. NCUA has interpreted the authority in the FCU Act for credit unions to participate in loans “with” other lenders to contemplate a shared, continuing lending arrangement. Additionally, the continuing participation of the lender that initially originated the loan is intended to ensure a safe and sound participation arrangement. The concern is that a lender “may have a decreased interest in properly underwriting a loan if they know they can later reduce their risk by selling participation interests in it.” Accordingly, we believe the intent of the rule is for the de facto originator, not the mere facilitator of the loan, to be required as a continuing participant in the loan.

<sup>8</sup> 12 C.F.R. § 701.23.

than its authority to purchase loans made by others to its members, provided two conditions are met.<sup>9</sup> First, the FCU must make the final underwriting decision regarding the making of an indirect loan. This is because the FCU may not delegate its lending authority to a third party.<sup>10</sup> Second, the retailer must assign the loan or sales contract to the FCU very soon after it is signed by the borrower and the retailer.

We believe it is reasonable to apply a similar analysis to determine if a FICU or eligible organization acting as lead lender as described above is the de facto originating lender in an indirect lending arrangement for purposes of the loan participation rule. Indirect lending is characterized by the retailer facilitating a loan using a FICU's or eligible organization's underwriting criteria, the FICU or eligible organization making the final underwriting decision, and the sales contract being assigned to the FICU or eligible organization very soon after it is signed by the borrower. If these conditions, as described more fully above, exist in a particular indirect lending arrangement, then the lead lender would qualify as the originating lender and, therefore, a participating FICU is permitted to purchase a participation in a loan generated through the referenced indirect lending arrangement.

The period of time that satisfies the "very soon after" element depends on the nature of the loan and the practical realities of assigning certain kinds of loans in the current marketplace and in accordance with prevailing industry standards. While "very soon after"<sup>11</sup> is determined on a case-by-case basis by loan type and in accordance with commercial reasonableness, NCUA's longstanding position is that the sooner the assignment is made the more likely the point of sale retailer will be viewed as a loan facilitator, not a loan originator. Contrarily, the longer the time between formation of the contract and assignment, the more likely the arrangement will be viewed as the purchase of a third party loan rather than the making of a loan through indirect channels.<sup>12</sup>

Please contact us with any questions.

Sincerely,



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15-0813

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<sup>9</sup> 12 C.F.R. §701.23(b)(4)(iv).

<sup>10</sup> Id.

<sup>11</sup> The preamble to the 1998 proposal to amend the eligible obligations rule requested public comment on whether NCUA should specify a certain number of days as constituting "very soon". 63 FR 41976, 41977 (Aug. 6, 1998). After considering the comments, however, the NCUA Board determined not to specifically define it because it wanted to provide FCUs with flexibility under various circumstances. The NCUA Board also clarified that assignment of the loan means acceptance of the loan and not necessarily the physical receipt of the loan documentation, recognizing that acceptance and payment are often done electronically. However, physical receipt of the loan documents by the FCU should occur within a reasonable time following acceptance of the loan. 63 FR 70997, 70998 (Dec. 23, 1998).

<sup>12</sup> 63 FR 41976, 41977 (Aug. 6, 1998).