

December 16, 1992

Guy Muraoka  
Kahului Federal Credit Union  
25 W. Kamehameha Avenue  
Kahului, Hawaii 96732

Re: Discounted Loan Rates (Your November 6, 1992, Letter)

Dear Mr. Muraoka:

You have asked whether a federal credit union (FCU) may offer discounted interest rates on loans for members who are considered by the FCU to be low-risk preferred members. The FCU Act and NCUA Rules and Regulations do not prohibit a policy of offering some members discounted interest rates on loans.

#### ANALYSIS

Section 107(5)(A) of the FCU Act (12 U.S.C. ~1757(5)(A)) authorizes an FCU to make loans to its members. An FCU board of directors may set interest rates on loans as long as they comply with the requirements set forth in Section 107(5) of the FCU Act and Section 701.21 of NCUA's Rules and Regulations (12 C.F.R. 701.21) and any other applicable state and/or federal law. Both sections of the FCU Act and the NCUA Rules and Regulations are silent on the permissibility of interest rate differentiation. While an FCU's board is given wide latitude under our regulations to set loan policies, we expect there to be a rational basis for distinguishing loan terms for different members on the same type of loan. Furthermore, any such policy must be applied uniformly. In sum, there is nothing in the FCU Act or NCUA Rules and Regulations prohibiting an FCU from establishing a written policy of charging a different interest rate on loans of the same type for different members, as long as there is a rational basis for the differentiation. We believe credit-worthiness of the member serves as a rational basis.

One cautionary note about the possible impact of Section 701.31 of NCUA's Rules and Regulation (12 C.F.R. 701.31) and the Equal Credit Opportunity Act on the loan program. FCUs may not deny real-estate related loans, nor discriminate in setting or exercising its rights pursuant to the terms or conditions of such loans, on the basis of race, color, national origin, sex, handicap of familial status. 12 C.F.R. ~701.31(b). A "real estate-related loan" is one made to finance or refinance the purchase, construction, improvement, repair or maintenance of a dwelling. 12 C.F.R. ~701.31(a)(3). You did not state whether the loan differentiation program involved real estate related loans, but if it does, Section 701.31 of NCUA's Rules and Regulations would be applicable. Although your proposed loan program, on its face, does not violate Section 701.31 of NCUA's Rules and Regulations, if it failed an "effects test," a violation may arise. The "effects test" is a judicial doctrine which, in essence, holds that policies may be discriminatory if the policy has a negative impact on persons intended to be protected by law, even if there is no intent to discriminate.

The Equal Credit Opportunity Act (ECOA) and Regulation B (12 C.F.R. 202) prohibit discrimination in all types of extensions of credit based on race, color, religion, national origin, sex, marital status, age, receipt of public assistance programs, and good faith exercise of rights under the Consumer Protection Act. Varying the loan interest rate based on some determination of creditworthiness may have a discriminatory effect, even though the terms of the loan appear neutral, and thus may fail the "effects test."

While it is the opinion of this Office that FCU's are not prohibited from engaging in this type of interest rate differentiation as long as a rational basis for the differentiation exists, you must consider state or other

federal laws (e.g. the Federal Bankruptcy Act) that may be applicable to such a loan program. In addition, although this loan program may be legally permissible, any safety and soundness issues remain the concern of NCUA's regional office.

Sincerely,

Hattie M. Ulan  
Associate General Counsel

GC/MM:sg  
SSIC 3228  
92-1130