

September 20, 1996

Edward A. Keirn
Barnes & Thornburg
1313 Merchants Bank Building
11 South Meridian Street
Indianapolis, Indiana 46204

Re: Credit Union Service Organization ("CUSO") Issues
(Your July 23, 1996, Letter)

Dear Mr. Keirn:

You have requested an opinion regarding the permissibility of certain CUSO indirect lending services. This letter generally addresses some of these issues, and requests that further information be sent to Region IV for analysis before a complete determination can be made.

BACKGROUND

Your client, a federal credit union ("FCU"), already has an existing CUSO engaging in several permissible services and activities, including insurance and securities brokerage, vehicle leasing, and consumer mortgage loan origination. Each of the current CUSO services and activities are provided almost exclusively to the FCU's membership.

The CUSO plans to expand its activities into the purchase of automobile retail installment contracts from automobile dealers. It is contemplated that these sales contracts would then be sold either to the FCU (if the obligor is a member) or to unrelated financial institutions (if the obligor is not a member). For marketability reasons, the non-member contracts would be held until a pool could be formed making the sale more profitable.

Although it is initially anticipated that most of the purchased contracts would involve members, it is the CUSO's position that all of the services and activities offered by a single CUSO need to be aggregated in order to determine if the CUSO's customer base requirement is met. You state:

Because of the nature of its six (6) other activities and services (which activities and services are almost exclusively for the benefit of FCU and its membership), CUSO logically should satisfy the previously described legal test(s) if, from time to time, it merely comes reasonably close to selling a majority of its retail installment contracts to FCU.

Your Letter, p. 3.

DISCUSSION

NCUA has permitted CUSOs to engage in limited indirect lending activities when the CUSO would be considered to be providing a support service for the FCU's programs. The preamble to the CUSO regulation explains that CUSOs are authorized to engage in loan processing, servicing, and sales activities to enable them to "provide a full range of support services for mortgage loans and for other loans originated by the credit union." 51 Fed.Reg. 10353, 10356 (March 26, 1986).

The salient features of an approved CUSO indirect lending program are as follows: (1) the FCU must have

an ongoing program of originating car loans; (2) the CUSO cannot purchase a loan until it has a binding contract for its immediate sale; (3) the CUSO must primarily serve credit unions or the membership of affiliated credit unions; and (4) the FCU can only purchase loans it is empowered to grant, or such loans must be refinanced in order that the loans be converted into loans it is empowered to grant. The FCU must carefully scrutinize the loans purchased to ensure that they conform to its credit policies and standards, and comply with applicable federal and state law. See, NCUA Examiner's Guide, Chapters 9 (Loans) and 16 (Compliance). In the event that CUSO employees engaged in an indirect lending program are deemed to be acting as FCU employees, such CUSO employees must obtain credit union fidelity bond coverage. If, however, the CUSO is strictly using an automated credit scoring system approved by the FCU, we have determined that a third party may use such a system to qualify credit union loans. You should also be aware that Section 701.23 of NCUA's rules limits the amount of "eligible obligations of its members" a credit union can purchase to 5 percent of the unimpaired capital and surplus of the purchaser. 12 C.F.R. §701.23. Depending on the size of the credit union involved, this regulation could impact the level of purchasing activity from the CUSO.

Your letter did state that the FCU will continue to maintain an ongoing program of originating car loans and that an agreement between the CUSO and the FCU for the immediate sale and purchase of indirect loans would be made. However, your letter did not clearly address the timing of such transactions, whether the loans are of a type that can be purchased by the FCU, or any bonding issues. Please address these issues in your subsequent correspondence.

As far as the proportion of member to nonmembers served by a CUSO engaged in indirect lending, NCUA does not provide specific guidance for determining whether a "CUSO primarily services credit unions." When the NCUA adopted the current CUSO rule, the NCUA Board declined to adopt a definition for the term "primarily". The Board concluded "that defining the term as a percentage of customers served would be arbitrary." 51 Fed.Reg. at 10355. However, CUSOs should offer services which it anticipates will serve a majority of FCU members. If a large part of a CUSO's activities are intentionally directed at parties other than credit unions or their members, such activities would be outside the scope of permissible CUSO services or activities.

Your letter has not demonstrated how provision of indirect loan services to nonmembers and non-affiliated credit unions and other types of financial institutions mainly supports the FCU's automobile lending activities to its members. To address this issue, please provide information regarding the nature and scope of the FCU's current automobile lending program, and compare it to the nature and scope of the proposed CUSO indirect lending program. Please provide information addressing each of the permissible CUSO indirect lending program issues stated in this letter. It would also be helpful to have information on the anticipated percentage of contracts that will be sold to institutions other than the FCU or affiliated FCUs. Please indicate how the membership status of, and other membership issues related to, the individual obligor are handled, i.e., current members, potential members, and nonmembers. Please also explain in detail the procedures that will be used to process the various categories of obligors based upon their membership status.

If you have any questions related to this letter, please call the Division of Supervision, Region IV (ph. 708-245-1000). Please address your correspondence to Nicholas Veghts, Region IV Director, NCUA, Region IV, 4225 Naperville Road, Suite 125, Lisle, IL 60532. The Region and the Office of General Counsel will coordinate a response based upon your correspondence.

Sincerely,

Richard S. Schulman

Associate General Counsel

GC/BKM/MJS/MSC:sg

SSIC 4600

96-0741

cc: Nicholas Veghts, Region IV Director