

April 27, 1998

Walter H. Hotz, Esquire
Hotz & Associates, P.C.
1979 Lakeside Parkway, Suite 200
Tucker, Georgia 30084

Re: Legal Opinion on Two Questions Posed by NCUA Region III
Your letter dated December 17, 1997

Dear Mr. Hotz:

You have written asking about the legality of a relationship between a large and small federal credit union (FCU) as it relates to the funding and purchasing of loans. As explained below, we believe the relationship is impermissible.

Funding of Loans

You have described the following scenario: A small FCU does not have the funds available at the time a loan is closing to fund the loan. A large FCU funds the loan. The loan closes in the name of the small FCU and the large FCU immediately purchases the loan. You state that in the commercial world, the transaction is characterized as a closing and simultaneous purchase. Region III states that the large FCU is funding the loan. Although we agree, that the transaction is a closing and simultaneous purchase, we also believe that the large FCU is funding and then purchasing the loan. In order for the transaction to be permissible, the large FCU must be in compliance with NCUA's regulation governing the purchase of eligible obligations. 12 C.F.R. §701.23(b). The legal requirements of this provision are set forth below in the discussion of "purchase of eligible obligations."

Since the large FCU is funding the loan due to liquidity problems of the small credit union, the FCUs may want to consider entering into a loan participation agreement. You should review §701.22 of NCUA's Regulations for the legal requirements of a loan participation agreement. 12 C.F.R. §701.22.

Purchase of Eligible Obligations

Your second question is whether a credit union that purchases nonmember loans must immediately move the loan into the secondary market. NCUA's regulation permits an FCU to purchase real estate secured loans, from any source, if the purchaser is granting such loans on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary mortgage market. 12 C.F.R. §701.23(b)(1)(iv). The attached letter from Richard S. Schulman to L.R. Dugan, dated May 26, 1995, citing the preamble to the rule, explains that FCUs will be expected to sell loans promptly and that arrangements to dispose of the loans should be made in advance of the purchase.

In addition, the attached §6030.4 of NCUA's Accounting Manual requires FCUs to make arrangements "in advance of the purchase date, by obtaining a commitment from a buyer, to purchase the pool of loans before it is actually packaged." From your description of the transaction, it does not appear that the FCU is complying with the requirement that arrangements to sell the loans be made prior to the purchase of the loans.

Sincerely,

Sheila A. Albin
Associate General Counsel

GC/MFR:bhs
SSIC 3500
97-1252

Enclosure

cc: Steven Dennison, Region III