

March 26, 1999

Philip Lacher, Internal Auditor  
Paragon Federal Credit Union  
370 Pascak Road  
Township of Washington, NJ 07675

Re: Loan Participation Program.

Dear Mr. Lacher:

You have asked whether Paragon Federal Credit Union's (Paragon's) small credit union loan participation program is permissible. As explained below, the answer is no.

Paragon has entered into loan participation agreements with several small credit unions. Under the program, Paragon uses its preprinted loan forms and approves, disburses and services the loans to the small credit union member. Paragon then seeks reimbursement of a part of the loan from the member's credit union. Paragon's attorney, Guy Messick provided an opinion, dated November 23, 1998, stating that this practice is permissible if the small credit union's name is listed as the lender on the loan documents and there is documentation in the loan file indicating the small credit union has approved the loan. The timing of the approval by the small credit union is unclear.

Contrary to Mr. Messick's opinion, the authority to service the loan does not include the authority to close and disburse the loan. Servicing begins after disbursement and constitutes all actions necessary to ensure proper handling of loans until finalized, either by payoff, collections, or charge-off. NATIONAL CREDIT UNION ADMINISTRATION EXAMINER'S GUIDE, p. 9-35 (1997). The participation rule states explicitly that a participating federal credit union, that is not an originating lender, must "obtain the approval of the board of directors or investment committee of the disbursement of proceeds **to the originating lender.**" 12 C.F.R. §701.22(d)(4) (emphasis added). The regulation contemplates that it is the originating lender that is funding the loan.

For this program to be permissible, the following must occur: the originating lender must approve the loan using its underwriting standards; approval by the originating lender must occur prior to disbursement of the loan; it should be clear to the member from the loan documents that he is contracting with the originating lender and not Paragon; the originating lender should issue the disbursement check; and the originating lender must retain at least 10% of the

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loan. Paragon may service the loan after it purchases its participation interest. 12 C.F.R. §701.22.(b)(3).

Sincerely,

Sheila A. Albin  
Associate General Counsel

GC/MFR:bhs  
SSIC 3000  
99-0239a

cc: Region II