

June 7, 2002

Katherine E. Weber, Esquire  
Lastowka & Messick P.C.  
The Madison Building  
108 Chesley Drive  
Media, PA 19063-1712

Re: Participation Interest in Personal Property Leasing.

Dear Ms. Weber:

You have asked if a federal credit union (FCU) may participate on a full recourse basis in personal property leases entered into between another credit union (CU) and the latter CU's members. As you have described the proposed activity, it is equivalent to a loan from the first credit union to the latter. The Federal Credit Union Act (the FCU Act) authorizes an FCU to lend to, and borrow from, another CU, and we have no legal objections to the proposed activity as described. 12 U.S.C. §1757(5)(C), (7)(C), (9).

The originating CU plans to enter into indirect leases of personal property, such as vehicles, with their members. The originating CU will also enter into a participation agreement with an FCU. You have described the participation agreement generally, but have not provided us with a sample or any other documentation. You state that, under the participation agreement, the participating FCU will provide the originating CU with funds to help finance the leases. In return, the participating FCU will receive an undivided percentage, not to exceed 90%, of the lease payments made by each lessee. The participating FCU will also have full recourse against the originating CU for the payments due if: the lessee defaults on any of its obligations, the leasing company defaults on any of its obligations, or there is a material adverse change in the leasing company's financial condition, and such default or adverse change is not cured within a specified number of days. In addition, our understanding is that the participating FCU will not become a joint lessor with the originating CU or have any interest in the residual value of the leased property.

In loan participation agreements, a participating CU generally looks to the member's loan payments to recoup its funds. In participation agreements with full recourse, the participating CU has the additional right to recoup its funds from the originating CU in the event of the member's default. Since the originating CU receives funds and is ultimately responsible for repayment, our view is that a full recourse participation arrangement is a borrowing between the two credit unions. Preamble to §701.22, Loan Participations, 46 Fed. Reg. 38678 (July 29, 1981). FCUs engage in full recourse loan participations pursuant to the FCU Act's provisions authorizing FCUs to lend to and borrow from other credit unions. 12 U.S.C. §1757(5)(C), (7)(C), (9).

NCUA permits FCUs to enter into leases to members as incidental to an FCU's lending authority. 12 C.F.R. Part 714. Leasing has risks similar to those found in lending, such as lessee default, but also has risks not found in traditional lending. In a lease, the lessor anticipates recouping its investment from lease payments and, also, from the sale of the leased property at the end of the lease, generally referred to as the residual value. There is a risk that the residual value of the leased property at the end of a lease may be less than the lessor estimated when entering into the lease. In indirect leasing arrangements, there is also the risk of default by the leasing company, which may significantly complicate a CU's ability to recoup its investment.

In your proposed leasing participation agreement, the originating CU will retain both the risks normally associated with lending and the risks unique to leasing. The participating CU does not become a joint lessor with the originating CU, does not rely on the residual value of the leased property, and has full recourse against the originating CU to recoup its funds in the event of default under the lease or default in an originating CU's indirect lease arrangement with a leasing company. Accordingly, as with full recourse participation lending, your proposed activity is the equivalent of a loan between CUs. FCUs may engage in the proposed activity under their authority to lend to and borrow from other CUs.

In carrying out the proposed activity, FCUs must comply with applicable law and regulations governing lending and leasing. For example, the board of directors must approve loans made by an FCU to another CU, and the total amount of loans to other CUs must not exceed 25 percent of the FCU's paid-in and unimpaired capital and surplus. 12 U.S.C. §1757(5)(C), (7)(C). Also, an FCU may not borrow from any one source, including another CU, an amount exceeding 50 percent of paid-in and unimpaired capital and surplus. 12 U.S.C. §1757(9). In addition, an FCU entering into a lease with its member must comply with NCUA's leasing rule. 12 C.F.R. Part 714. We defer to state authorities on the permissibility of this arrangement for state-chartered CUs.

Sincerely,

Sheila A. Albin  
Associate General Counsel

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