June 17, 2002

Re: Application of the Fixed Asset Rule to Data Processing Contracts.

Dear :

You have asked if a multi-year contract for data processing must be considered a lease and, therefore, included as a fixed asset for purposes of our fixed asset rule that limits federal credit union (FCU) ownership of fixed assets. 12 C.F.R. §701.36(c)(1). Payments for data processing contracts are subject to our fixed asset rule because the contract depends on the use or lease of computer hardware and software, which is considered an investment in fixed assets.

The fixed asset rule provides that "[n]o FCU . . . without the prior approval of NCUA, shall invest in fixed assets if the aggregate of all such investments exceeds 5 percent of the FCU's shares and retained earnings." Id. An FCU must comply with the fixed asset rule unless the FCU is under $1,000,000 in assets or is exempt under NCUA's Regulatory Flexibility Program. Id.; 12 C.F.R. Part 742. "Fixed assets" includes computer hardware and software. 12 C.F.R. §701.36(b)(2), (3). "Investment in fixed assets" means not only the purchase of fixed assets but also "the aggregate of all capital and operating lease payments pursuant to lease agreements for fixed assets." 12 C.F.R. §701.36(b)(4)(iii).

Data processing requires substantial use of computer hardware and software. In the preamble to the final fixed asset rule, the NCUA Board addressed the treatment of data processing contracts as follows:

> [Section 701.36(b)(4)(iii)] states that aggregate lease payments pursuant to a lease agreement on fixed assets are covered by the [fixed asset rule]. Many of the comments mentioned the use of leases in connection with data processing of credit union records. Using this example, a credit union has some options: an outright purchase or a lease of the hardware and software (there may even be variations of these two options). All would agree that the purchase of hardware and software represent an obvious investment in fixed assets. In the second option, the use of the lease, usually long term, represents a substantial future commitment of credit union funds and it is used in lieu of purchasing the items. The use of the lease is actually the equivalent of the purchase. This is particularly evident when the cost to purchase is equal to or less than the lease payments. While we are aware that there are many other fees paid under a data processing lease, it is impossible to view these payments as independent since all are usually tied, directly or indirectly, to hardware and/or software use. It would be difficult, if not impossible, to segregate portions of these fees as non-fixed assets due to the dependence on the entire system to produce the product.

54 Fed. Reg. 18466 (May 1, 1989).

In our view, unless an FCU can separate fixed asset payments, including payments for the use of hardware and software, from payments made for non-fixed assets, it must count its entire financial commitment under a data processing contract towards the fixed asset rule's 5% limitation. The burden is on the FCU to support and document any segregation of payments into fixed asset and non-fixed asset categories.

Sincerely,

Sheila A. Albin
Associate General Counsel

GC/PMP:bhs
SSIC 3501
02-0460

cc: Regional Director, Region II