

November 5, 2002

Guy A. Messick, Esquire
Lastowska & Messick P.C.
The Madison Building
108 Chesley Drive
Media, PA 19063-1712

Re: Loan Participations in Loans with Prepayment Penalties.

Dear Mr. Messick:

You have asked if a federal credit union (FCU) may participate in a loan originated by a state-chartered credit union (SCCU) that contains a provision for prepayment penalties. Yes, an FCU may participate in such a loan if it does not receive any portion of the prepayment penalty and its *pro rata* share of the penalty is forgiven.

You represent FCUs that want to enter into loan participation agreements with SCCUs on loans that contain a provision for a prepayment penalty. Under these agreements, participating FCUs would not receive any money derived from prepayment penalties charged under the originating SCCU's loan contracts with borrowers.

NCUA's rule on loan participations only permits FCUs to participate in loans "it is empowered to grant."¹² C.F.R. §701.22(d)(1). This prerequisite to loan participation is also found in NCUA's rule on eligible obligations.¹² C.F.R. §701.23(b)(1)(i). The FCU Act allows an FCU to make loans under several conditions including that the borrower may "repay his loan, prior to maturity in whole or in part . . . without penalty."¹² U.S.C. §1757(5)(A)(viii). An FCU, therefore, is not empowered to grant a loan with a prepayment penalty.

In legal opinion 96-0922, dated November 22, 1996, which is available on our website, we determined that an FCU cannot purchase eligible obligations containing a prepayment penalty unless the penalty is excluded from the loan contract before the FCU purchases it or the FCU refinances the loan within 60 days. Likewise, we conclude that an FCU cannot purchase an interest in a loan through a loan participation agreement if it receives a fee due to the borrower's prepayment.

An FCU may only participate in a loan contract containing prepayment penalties if its purchase of a participation interest is consistent with NCUA's lending rules, including the prohibition on prepayment penalties. We believe an SCCU's collection of any part of a prepayment penalty that would otherwise belong to the FCU also bars the FCU's participation. The FCU Act protects borrowers from these prepayment penalties and, if an SCCU retained an FCU's portion of these charges, the consumer protections built into the FCU Act would be defeated. Our opinion is that, while an SCCU may charge a penalty for prepayment of a loan, the SCCU may only collect its *pro rata* share of the penalty if an FCU participates in the loan. FCUs participating in loans originated by SCCUs should ensure that borrowers receive appropriate disclosures in their loan agreements about the calculation of prepayment penalties in the event an FCU purchases a participation interest.

Sincerely,

Sheila A. Albin

Associate General Counsel

GC/CJL:bhs

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