September 8, 1997

Hans R. Ganz, President/CEO
Pacific Trust Federal Credit Union
P.O. Box 5227
Chula Vista, California 91912-5227

Re: Business Lending Rule -- Associated Members
Your Letter dated March 31, 1997.

Dear Mr. Ganz:

You have requested a legal opinion on whether three individuals who received loans

from a federal credit union and who are joint owners of a property management company that manages their individually owned properties, are "associated members" under NCUA's member business loan rule, Section 701.21(h) of NCUA's Regulations. Under the facts presented, these individuals are "associated members" under the rule.

BACKGROUND

Pacific Trust Federal Credit Union (FCU) has made 10 loans, secured by non-owner occupied real property, to three members for a total of $2.75 million. The FCU's loan to one borrower limit is $2.1 million. The FCU calculated the loans to one borrower amount by adding all loans per the recorded ownership of the security to determine if a group of borrowers should be considered "associated members" pursuant to NCUA's member business loan rule. If two of the borrowers are joint owners of a business or property which was not financed by the FCU, the FCU did not consider them "associated members" for the purposes of the member business loan rule.

During a recent exam, the NCUA examiner concluded the three borrowers are "associated members" because all three borrowers are joint owners of a property management company that manages the borrowers' individually-owned properties. These properties are security for individual loans the FCU made to the three borrowers. It is our understanding that the FCU has not made any loans to the property management company. The examiner concluded that, if all three borrowers were "associated members," then the FCU had violated the loans to one borrower limitation of the member business rule.

ANALYSIS

Section 701.21(h)(2)(iii)(A) states in part that:

Unless a greater amount is approved by the NCUA regional director, the aggregate amount of outstanding member business loans to any one member or group of associated members shall not exceed 15% of the credit union's reserves (less the allowance for Loan Losses account), or $75,000, whichever is higher.

An "associated member" is defined as "any member with a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower." 12 C.F.R. §701.21(h)(1)(iii). When the NCUA Board proposed the term "associated member" in 1986, it stated that the term describes:

a member who, along with other members, borrows funds from a FICU [federally insured credit union] where each member has a common ownership, investment, or other pecuniary interest in a business or commercial endeavor. In singling out these members, the Board is attempting to properly ascribe the ultimate beneficiary (e.g. the common business enterprise) of the loans obtained from the credit union and sufficiently allocate the total exposure that a FICU may have when making loans to one or more associated members. It is not uncommon to see members individually obtain loans for the same business venture, with each member assigning (transferring, investing etc.) the proceeds of the loan to the business. In almost all instances, repayment is directly tied to the success of the business and its ability to repay the loan(s). In order to properly aggregate the total exposure that a group of such loans poses to a FICU . . . the Board has created and defined the term "associated member."

Proposed Rule, 51 Fed. Reg. 23234, 23235 (June 26, 1986).

You state in your letter that:

Just because the same management company is employed to manage the underlying properties does not affect the economic viability of the underlying assets since it is not uncommon that real estate investors change management companies without affecting the economic viability of the underlying security.

We disagree. First, we think it is unlikely that a real estate investor is going to change from a management company in which that investor has an ownership interest. Second, the economic viability of the property underlying the loan, to a large degree, is dependent on the efforts and success of the management company.

You state that, when analyzing whether borrowers are "associated members," the analysis is limited to shared interests, investments or other pecuniary interests involving loans from the credit union in question. We agree. In further support of your position, you quote and rely on an earlier legal opinion from this office that dealt with loans to a group of members, all of whose loans were secured by corporate stock that the members had in the same corporation. In that case, we focused particularly on the fact that the failure of the underlying security for one loan, namely the corporate stock, would be linked to the failure of the security for all the other loans, which was also stock in the same corporation. Even without a direct link between the underlying collateral on the loans to be aggregated, however, borrowers may be considered associated members if they otherwise fall within the definition of the associated member definition.

In your case, the individual borrowers are within the scope of the "associated member" definition since they have a "shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower," namely, the management company. The repayment of the loans granted by the FCU is dependent on the ultimate success of the management company in running the properties. Under the facts presented, the borrowers are "associated members"

under NCUA's member business loan rule, and the FCU has violated the loan to one borrower limitation.

Sincerely,

Sheila A. Albin
Associate General Counsel

GC/MJMcK:bhs
SSIC 3501
97-0407

cc: Region VI