

September 21, 2004

(b)4

Re: Processing a Member's Loans on a Fee-for-Service Basis.

Dear (b)4

You have asked if a federal credit union (FCU) may provide loan processing services, including underwriting, on a fee basis for its sponsor and member, (b)4. As discussed below, the services you have described are authorized as an incidental powers activity. 12 C.F.R. Part 721.

Background

The University funds private loans to students of the University and their parents. The University, a member of the FCU, has asked it to undertake processing the loans on its behalf. In exchange for a fee, the University would like the FCU to perform the following functions:

- Obtain a credit report and credit score
- Ensure compliance with the USA Patriots Act
- Verify income, employment and other pertinent information
- Calculate a debt to income ratio
- Render a lending decision based on lending criteria established for this type of loan
- Provide a next day conditional approval
- Report to the University the status of each application
- Send out an Adverse Action form for denials
- Discuss application issues with the borrower

The FCU would not be responsible for disbursing any proceeds or servicing the loan. The FCU's field of membership also includes the students of the University and immediate family members. Although all the borrowers may not be members of the FCU, they will all be students who are eligible for membership; as noted below, we conclude the membership status of the student borrowers is not material.

Analysis

The Federal Credit Union Act and Part 721 of the National Credit Union Administration's (NCUA's) regulations authorize an FCU to engage in activities incidental to its business. 12 U.S.C. §1757(17); 12 C.F.R. §721.1. Section 721.2 contains a three-part test for determining if a particular activity is within an FCU's

incidental powers, and §721.3 lists several preapproved incidental powers categories. 12 C.F.R. §§721.2, 721.3. Section 721.4(a) authorizes the NCUA Office of General Counsel to issue advisory opinions, upon request, “as to whether a proposed activity fits into one of the authorized categories or is otherwise within [the requester’s] incidental powers.” 12 C.F.R. §721.4(a).

Although loan processing on a fee basis for a member does not readily fit into any of the preapproved activity categories, it does satisfy the three-part test for an incidental power activity. The preamble to the proposed version of the current incidental powers rule states that:

The Board does not believe it is necessary to link an incidental power directly to an express power enumerated in the FCU Act but generally will consider an activity to be within an FCU's incidental powers if it is “necessary or requisite to enable it to carry on effectively the business for which it is incorporated.” 12 U.S.C. 1757(17). The Board believes the business of FCUs is to provide financial services to their members as contemplated by the FCU Act.

In determining whether an activity is authorized as an appropriate exercise of an FCU's incidental powers, the Board will consider: (1) Whether the activity is convenient or useful in carrying out the mission or business of credit unions consistent with the Federal Credit Union Act; (2) whether the activity is the functional equivalent or logical outgrowth of activities that are part of the mission or business of credit unions; and (3) whether the activity involves risks similar in nature to those already assumed as part of the business of credit unions.

65 Fed. Reg. 70526, 70528 (Nov. 24, 2000). This three-part test was adopted in §721.2 of the final rule. Applying this test to the contemplated activity:

(1) Loan processing for a corporate member is convenient and useful in carrying out the mission or business of credit unions consistent with the Federal Credit Union Act.

As the NCUA Board stated above, the business of credit unions is to provide financial services to members. Loans are financial products, loan processing is a financial service, and the recipient of the service, the University, is a member of the FCU. In addition, the member University makes the loans in question to other members of the FCU or to individuals who are within the field of membership of the FCU. Because we view the proposed activity as a financial service to the University, which is a member, and the FCU is not itself making the loan to the

student borrowers, we conclude that the membership status of the students who receive the loan from the University is legally immaterial to our analysis. Nevertheless, we appreciate that this loan processing relationship with the University will provide a financial service to a broad swath of its membership. In addition, the FCU may be able to use the information it obtains from the loan processing relationship to market to potential natural person members and also help it refine other financial services that the credit union offers directly to its natural person members, subject to financial privacy and other applicable laws on the transfer of personal information.

(2) Loan processing for a corporate member is the logical outgrowth of activities that are part of the mission or business of credit unions.

The FCU already does loan processing for the loans it originates. Offering this same service in support of a member's loan originations is a logical outgrowth of the FCU's mission and business.

(3) Loan processing involves risks similar in nature to those already assumed as part of the business of credit unions.

As with any business activity, there are risks associated with the proposed processing activity. The risks, however, are similar in nature to those associated with the processing of loans originated by the FCU.

While the proposal satisfies the three-part permissibility test of the incidental powers rule, the risks associated with this activity require the FCU to enter into it carefully. For example, if loan applicants allege violations of the Equal Credit Opportunity Act the FCU may face both reputation damage and legal liability issues. We recommend that you employ a knowledgeable attorney to assist you in drafting a contract with the University that spells out the relative rights and responsibilities of the FCU and the University and limits the FCU's liability to the University and loan applicants.

Sincerely,

/S/

Sheila Albin
Associate General Counsel