

May 1, 2006

Cheryl A. DeBoer, President/CEO
First Community Federal Credit Union
550 S. Riverview Drive
Parchment, MI 49004

Re: Board of Director Conflict of Interest.

Dear Ms. DeBoer:

You have asked if investments one of your directors has in certain businesses violate the conflict of interest provision in NCUA's lending rule. 12 C.F.R. 701.21(c)(8)(i). Yes, the director's ownership interest in companies that provide indirect lending services and through which the credit union has sold insurance violates the regulation.

You described the following circumstances in your correspondence. A director is an owner in affiliated companies, one of which has been involved in providing services to the credit union in connection with its indirect lending operations, including disseminating information to automobile dealerships about the credit union's rates and lending procedures and providing a fee processing service. The credit union pays the company a fee for these services on a per loan basis. The affected director proposes that the compensation formula be changed to a flat monthly fee instead of a fee per loan and that this compensation could be "assigned" to another of the affiliated companies, but one in which he does not have an ownership. Another company in which the director has an ownership interest brokers the sale of GAP insurance the credit union offers to borrowers. GAP insurance, which is sold to borrowers in connection with auto loans, usually pays the difference between the actual cash value of a vehicle and the outstanding balance on a loan if a loss occurs. GAP insurance is in addition to a borrower's regular casualty insurance and sometimes will also cover the deductible under that coverage.

The conflict of interest provision in NCUA's lending rule states that "no official or employee of a Federal credit union . . . may receive, directly or indirectly, any commission, fee, or other compensation in conjunction with any loan made by the credit union." 12 C.F.R. 701.21(c)(8)(i). This is a broad prohibition and we have stated previously:

The purpose of the provision is to ensure that the decisions a federal credit union goes through at the various stages of making a loan will not be influenced by the receipt of things of value by those at the credit union involved in such decisions [T]he prohibition

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is clear and absolute and the regulation does not provide for any waivers. Either, Ms. Y must resign her current position at the credit union or the credit union must cease doing business with . . . [the companies owned by her immediate family member].

OGC Legal Opinion 94-0123 (February 16, 1994)(available on the NCUA website at ncua.gov).

The rule helps ensure credit unions make appropriate decisions regarding lending. The board of directors is responsible for setting lending policies and criteria, and, in some circumstances, including those described above, there is an obvious conflict when a director will benefit if loan volume increases. The board of directors may also have to make other lending related decisions in the circumstances you described that, although not directly related to loan volume, also present a conflict of interest in violation of the lending rule. For example, in the future, your credit union may consider if it should make changes in its indirect lending program; if it should cease offering certain insurance with its loan products; or if it should use a different marketing agent or insurance broker. Directors and management must be free to consider these lending issues without any economic incentive to act contrary to the best interests of members.

We also considered the potential solutions the affected director offered, including reducing the compensation, changing the form of the compensation, or rerouting the compensation through other companies. None of these proposals satisfy the rule. The rule has no exception for small dollar amounts and applies to any compensation whether received directly or indirectly. 12 C.F.R. 701.21(c)(8)(i). It also applies whether or not the compensation is tied to a particular loan. OGC Legal Opinion 92-0709 (August 26, 1992)(copy attached).

In connection with the GAP insurance sales, you asked if the director would still be in violation of the rule if his company sold the insurance to borrowers through auto dealers and not through the credit union. You stated these would be the same dealers with which the credit union conducts indirect lending transactions. The conflict of interest prohibition in the lending rule does not apply to:

Receipt of compensation from a person outside a Federal credit union by a volunteer official or non senior management employee of the credit union . . . for a service or activity performed outside the credit union, provided that no referral has been made by the credit union or the official, employee, or family member.

12 C.F.R. §701.21(c)(8)(iii)(D). This is a limited exception. It applies only to activities performed outside the credit union for some other party and when there is no referral or "steering" by the credit union to the product or service. 60 Fed. Reg. 51886,

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51887 (Oct. 4, 1995). We remain concerned in these circumstances because of the indirect lending relationship between the credit union and the auto dealers, which would replace the credit union in making the sales of the insurance. We question if making the proposed change is in the interest of the credit union and its members. Further, we note the fact that, as a director, the affected director remains in a position to influence the indirect lending arrangements the credit union establishes with auto dealers that, in turn, could affect sales of GAP insurance.

If you have any further questions, please feel free to contact Staff Attorney Paul Peterson or me at 703/518-6540.

Sincerely,

/S

Sheila A. Albin
Associate General Counsel

OGC/PMP:bhs
06-0210
Enclosure