

July 23, 1993

Mitchell B. Klein, Esq.  
General Counsel  
Police and Fire  
Federal Credit Union  
901 Arch St.  
Philadelphia, PA 19107-2495

Re: Election to Membership (Your Letter of June 12, 1993)

Dear Mr. Klein:

You requested an opinion regarding the use of credit reports as a factor to be used in approving a potential member for membership in a federal credit union ("FCU"). Although the use of credit reports as a factor to be used in disapproving a potential member for membership does not violate the letter of the FCU Act, the NCUA does discourage such use as contrary to the intent and spirit of the FCU Act.

#### BACKGROUND

The Police and Fire FCU has considered obtaining a Chex System Report ("Chex Report") on all potential members applying for membership, and disapproving the membership application if certain negative information is revealed on the Chex Report. According to you, the Chex Report, in addition to reporting bad credit, also indicates whether a potential member has committed automated teller machine fraud or has been writing or passing checks with insufficient funds. The information provided on a Chex Report, you maintain, is therefore more comprehensive than that provided by a conventional credit report. The FCU projects that this would help prevent future FCU losses.

#### ANALYSIS

NCUA has long held that an FCU's board of directors may impose membership requirements in addition to those set forth in the FCU Act, as long as there is a rational basis for such requirements. Section 109 of the FCU Act states:

[FCU] membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Board, as may be elected to membership. . . . 12 U.S.C. ~1759 (emphasis added).

Section 113 of the FCU Act authorizes an FCU board of directors to "act upon applications for membership," to "review at each monthly meeting a list of approved and pending applications for membership," and to "provide for the furnishing of the written reasons for any denial of a membership application to the applicant upon the request of the applicant." 12 U.S.C. ~1761b(1), (15) and (16).

Read together, Sections 109 and 113 of the FCU Act grant an FCU's board of directors discretion in acting upon application for FCU membership. Neither the FCU Act nor the Regulations imposes any limitations on that discretion, although we do believe that there should be some rational basis for rejection of a particular applicant. In your case, the board of directors apparently feels that admission of an individual with a "bad" Chex Report will result in liability, loss or other harm to the FCU. It is our opinion that the FCU's board of directors may take the credit history of an individual into account when deciding whether to admit such individual into membership. We offer no opinion as to whether a board's denial of a

membership application based upon credit history would contravene other federal or state law, particularly antidiscrimination laws. We would caution that the bankruptcy laws are generally strict on denial of credit to those who have declared bankruptcy, and suggest you consult with local counsel on this issue. Moreover, we caution that if the FCU is engaging in the Chex Report review as part of a loan prescreening program, that such use may be impermissible under the Fair Credit Reporting Act ("FCRA"). See Federal Trade Commission's Official Commentary on FCRA, 55 Fed.Reg. 18804, 18815 (May 4, 1990). If this is the case, we suggest that you explain your loan prescreening program in more detail to the NCUA, as the NCUA has jurisdiction for FCRA violations of FCUs. 15 U.S.C. ~16921(b)(3).

FCUs were created in order to provide credit to individuals of small means, and people who would otherwise not have access to basic financial services. NCUA encourages FCUs to offer membership to all applicants within the FCU's field of membership. If a member later causes problems or losses to the FCU, the FCU may limit or suspend services to such member, or prepare to expel the member from membership. See Letter from Hattie M. Ulan, NCUA Associate General Counsel, to Scott Draughon, Oklahoma Credit Union League Affiliates, Re: Expulsion and Suspension of Credit Union Services Based on Causing a Loss, dated March 28, 1989 (enclosed); see also Letter from Ms. Ulan to Charles Williams III, Esq., Blalack & Williams, Irving, TX, Re: FCU Membership of Nonresident Alien; Use of IRS Number; Alteration of Signature Card, dated December 21, 1992 (enclosed); Letter from Ms. Ulan to Judy Kelly, IBM Employees Southwest FCU, Re: Denial of a Share Draft Account, dated August 25, 1989 (enclosed); and Letter from Ms. Ulan to Keith Burton, Granite City Steel Employee's FCU, Re: Suspension of Credit Union Services, dated March 30, 1989 (enclosed). It is even conceivable that the FCU could establish higher loan interest rates for higher risk borrowers, to reflect potential risks and losses, in certain circumstances. See Letter from Ms. Ulan to Jeffrey Gray, Harding & Associates, Re: Loan Differentiation, dated November 4, 1991 (enclosed). We urge you to consider all available alternatives before denying a potential member membership in your FCU.

Sincerely,

James J. Engel  
Deputy General Counsel

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SSIC 3000  
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Encl.