

Jeffrey S. Gray
Harding & Associates, P.C.
110 South Main Street
Pleasant Grove, Utah 84062

Re: Loan Differentiation (Your September 6, 1991, Letter to Stephanie Jones)

Dear Mr. Gray:

You have asked whether a federal credit union (FCU) may charge different interest rates on the same type of loan based on either the borrower's credit rating or debt ratio. The FCU Act and NCUA Rules and Regulations do not prohibit such a loan differentiation program.

ANALYSIS

Section 107(5)(A) of the FCU Act (12 U.S.C. ~1757(5)(A)) authorizes an FCU to make loans to its members. An FCU board of directors may set interest rates on loans as long as they comply with the requirements set forth in Section 107(5) of the FCU Act and Section 701.21 of NCUA's Rules and Regulations (12 C.F.R. 701.21) and any other applicable state and/or federal law. Both sections of the FCU Act and the NCUA Rules and Regulations are silent on the permissibility of interest rate differentiation. While an FCU's board is given wide latitude under our regulations to set loan policies, we expect there to be a rational basis for distinguishing loan terms for different members on the same type of loan. Furthermore, any such policy must be applied uniformly. In sum, there is nothing in the FCU Act or NCUA Rules and Regulations prohibiting an FCU from establishing a written policy of charging a different rate on loans of the same type based on the borrower's credit rating or debt ratio, as long as there is a rational basis for the differentiation.

One cautionary note about the possible impact of Section 701.31 of NCUA's Rules and Regulation (12 C.F.R. 701.31) and the Equal Credit Opportunity Act on the loan program. FCUs may not deny real estate-related loans, nor discriminate in setting or exercising its rights pursuant to the terms or conditions of such loans, on the basis of race, color, national origin, sex, handicap, or familial status. 12 C.F.R. ~701.31(b). A "real estate-related loan" is one made to finance or refinance the purchase, construction, improvement, repair or maintenance of a dwelling. 12 C.F.R. ~701.31(a)(3). You did not state whether the loan differentiation program involved real-estate related loans, but if it does, Section 701.31 of NCUA's Rules and Regulations would be applicable. Although your loan differentiation program, on its face, does not violate Section 701.31 of NCUA's Rules and Regulations, if it failed an "effects test" a violation may arise. The "effects test" is a judicial doctrine which, in essence, holds that policies may be discriminatory if the policy has a negative impact on persons intended to be protected by law, even if there is no intent to discriminate.

The Equal Credit Opportunity Act (ECOA) and Regulation B (12 C.F.R. 202) prohibit discrimination in all types of extensions of credit based on race, color, religion, national origin, sex, marital status, age, receipt of public assistance programs, and good faith exercise of rights under the Consumer Credit Protection Act. Varying the loan interest rate based on the borrower's credit rating or debt ratio may have a discriminatory effect, even though the terms of the loan appear neutral, and thus may fail the "effects test."

While it is the opinion of this Office that FCU's are not prohibited from engaging in this type of interest rate differentiation, you must consider state or other federal laws (e.g. the Federal Bankruptcy Act) that may be applicable to such a loan program. In addition, although this loan program may be legally permissible, it may raise safety and soundness concerns in NCUA's regional office. You may wish to continue

coordinating your activity with your NCUA examiner and the regional office.

Sincerely,

Hattie M. Ulan
Associate General Counsel

GC/MM:sg
SSIC 3000
91-1005

cc: Gene Jackson, Region V
Director, Division of Insurance