

Colleen Shishido, Loan Manager
Oahu Teachers No. 2 Federal Credit Union
233 S. Vineyard Street
Honolulu, HI 96813

Re: Acceptance of Nonmembers as Joint Applicants on a Loan
(Your June 6, 1995, Letter)

Dear Ms. Shishido:

You requested an opinion regarding the ability of a federal credit union (FCU) to permit nonmembers to participate in loans to members. We apologize for the delay in our response.

Section 107(5) of the FCU Act (Act), 12 U.S.C. §1757(5), only authorizes an FCU to make loans to its members. Nonmembers can participate in loans as long as their involvement does not distort the direct lending relationship between the FCU and the member. * If the nonmember directly receives the use or benefit of the loan proceeds, they would be an impermissible participant and the loan would violate the Act.

Potential loans with nonmember involvement must be analyzed to determine whether they would violate Section 107(5) of the Act. Some of the elements that an FCU must consider in its analysis include, the loan size in relationship to the member's income and existing debts, who is pledging the collateral, who is the primary obligor, and who has use and benefit of the loan proceeds.

You stated in your letter that you "would like to consider all joint applicants as joint applicants"; . . . "[j]oint applicants who are not members, cannot apply for a loan *on their own*." (Emphasis added). Your statement reflects a misunderstanding that a nonmember can obtain a loan as a joint applicant with an FCU member. This is not correct. There is no authority for an FCU to make nonmember loans. As discussed herein, the nonmember's participation is to assist the member in securing the loan. Any benefits to the nonmember must be incidental.

You have requested our comments on two examples. In each example, a member applies for a debt consolidation loan with a nonmember co-signer or joint applicant. In your first example, the nonmember applicant is the member's spouse who is sharing in the proceeds of the loan. In the second example, the member and the nonmember are not related. While the nonmember in the second example has an adequate employment and credit history, the member does not. In both examples, you have stated that the member would not qualify for the loan on his/her own.

You state that your credit committee would approve the loan in the first example but not in the second because it would consider the married couple as joint applicants. As joint applicants, each person's income and debts are combined for a single debt ratio, which usually results in a more creditworthy application. When the applicants are not considered joint applicants, it is more difficult to approve the loan under your FCU's policies because each individual must have sufficient income to repay their own as well as the new debt.

In the first example, although the wife is not a member, (and, as you indicate, there are instances where she may not be eligible for membership) she will be sharing in the proceeds of the loan. Generally, due to the marital relationship, the member will be jointly and severally liable on the marital debt to be consolidated. So, even though the nonmember spouse would benefit from the loan proceeds, the member can also be said to receive the entire benefit. Generally, too, the marital estate would be available to satisfy marital debts. Therefore, your assumption that marital status "should not have any bearing in the qualifying process" is inaccurate. If the debt to be consolidated is the individual debt of the member husband, treating the nonmember wife as a joint applicant

would serve to provide additional assurance of marital estate assets being available as a source of repayment. If the individual debt was that of the nonmember wife, however, this would be an impermissible loan to a nonmember and a joint application would not be appropriate.

In your second example, two unrelated individuals are applying for a loan to consolidate "both of their debts." Because the loan is being made to consolidate a nonmember's debts, an FCU loan is not appropriate. The FCU may make this loan only if the nonmember joint applicant is not going to directly benefit from the loan but is providing the FCU with a greater assurance for repayment. The FCU may also deny the loan based on the member's credit history.

We apologize for not offering you conclusive answers to your questions. The final judgment is appropriately left in the hands of the party with the facts, the credit union. Once the transaction's legality under Section 107(5) of the Act has been established, the FCU should follow the appropriate guidelines to determine whether the applicants qualify for the loan.

Sincerely,

Richard S. Schulman
Associate General Counsel

GC/JM:sg
SSIC 3500
95-0616
Enclosures

* My letter to Hal Heil, US FCU, Re: Loans involving Nonmembers, dated January 25, 1995; Letter from Steve Bisker, Assistant General Counsel to Bill Blubaugh, DM FCU, dated May 29, 1987; Letter from Mr. Bisker to John P. Patterson, National Institutes of Health FCU, dated December 1, 1986; and Letter from Robert Fenner, NCUA Director of Legal Services to Brian R. Witt, Esq., dated October 2, 1984 (all enclosed).