

the prohibitions in § 711.3, if NCUA finds that the interlock would not result in a monopoly or substantial lessening of competition, and would not present other safety and soundness concerns.

(b) *Presumptions.* In reviewing applications for an exemption under this section, NCUA will apply a rebuttable presumption that an interlock will not result in a monopoly or substantial lessening of competition if the depository organization seeking to add a management official:

- (1) Primarily serves, low-and moderate-income areas;
- (2) Is controlled or managed by persons who are members of a minority group or women;
- (3) Is a depository institution that has been chartered for less than two years; or
- (4) Is deemed to be in "troubled condition" as defined in § 701.14(b)(3) of this chapter.

(c) *Duration.* Unless a shorter expiration period is provided in the NCUA approval, an exemption permitted by paragraph (a) of this section may continue so long as it would not result in a monopoly or substantial lessening of competition, or be unsafe or unsound. If the NCUA grants an interlock exemption in reliance upon a presumption under paragraph (b) of this section, the interlock may continue for three years, unless otherwise provided in the approval.

5. Section 711.7 is amended by revising paragraph (a) to read as follows:

§ 711.7 Change in circumstances.

(a) *Termination.* A management official shall terminate his or her service if a change in circumstances causes the service to become prohibited. A change in circumstances may include, but is not limited to, an increase in asset size of an organization, a change in the delineation of the RMSA or community, the establishment of an office, an increase in the aggregate deposits of the depository organization, or an acquisition, merger, consolidation, or reorganization of the ownership structure of a depository organization that causes a previously permissible interlock to become prohibited.

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 714

Leasing

AGENCY: National Credit Union Administration (NCUA).

ACTION: Notice of proposed rulemaking and request for comment.

SUMMARY: The NCUA Board is proposing to update and redesignate its long-standing policy statement on leasing, Interpretive Ruling and Policy Statement (IRPS) 83-3, as an NCUA regulation. IRPS 83-3 authorizes federal credit unions to engage in either direct or indirect leasing and either open-end or closed-end leasing of personal property to their members if such lease financing arrangements are the functional equivalent of secured loans. In addition, the proposed regulation formalizes NCUA's position, stated in legal opinion letters, that a federal credit union does not have to own the lease property in indirect leasing if certain requirements are satisfied.

DATES: Comments must be received on or before January 27, 1999.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428. Fax comments to (703) 518-6319. E-mail comments to boardmail@ncua.gov. Please send comments by one method only.

FOR FURTHER INFORMATION CONTACT: Nicole Sippial Williams, Staff Attorney, Division of Operations, Office of the General Counsel, at the above address or by telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

As part of its regulatory review program, NCUA reviewed its Interpretive Rulings and Policy Statements (IRPS) to determine their current effectiveness. As a result of this review, the NCUA Board determined that a number of the IRPS should be withdrawn because they were outdated or unnecessary, and that certain IRPS should be redesignated as NCUA regulations to clarify and more effectively communicate NCUA's position on issues affecting federal credit unions (FCUs). 62 FR 11773 (March 13, 1997). Thereafter, twenty-eight (28) IRPS were withdrawn. 62 FR 50245 (September 25, 1997). This was NCUA's first step in its ongoing project to update and streamline its IRPS.

At this time, NCUA is in the second phase of the IRPS project, that is, the redesignation of certain IRPS as NCUA regulations. Among those IRPS that the NCUA Board determined would be better suited as a regulation is IRPS 83-3, Federal Credit Union Leasing of Personal Property to Members. 62 FR 11773 (March 13, 1997). The NCUA Board's goal in redesignating this IRPS is to increase regulatory effectiveness by establishing a rule that sets forth NCUA's current position on leasing and by making it easier for an FCU to locate the rule and its requirements.

In 1983, the NCUA Board issued IRPS 83-3 (48 FR 52568, Nov. 21, 1983) stating that FCUs can lease personal property to their members if the leasing of the personal property is the functional equivalent of secured lending. The NCUA Board did not want FCUs to assume burdens or subject themselves to risks greater than those ordinarily incident to secured lending. The NCUA Board determined that for leasing to be the functional equivalent of lending, a lease had to be a net, full payout lease with a residual value not exceeding 25% unless guaranteed. In addition, an FCU had to retain salvage powers over the leased property and maintain a contingent liability insurance policy with an endorsement for leasing.

The NCUA Board further stated that FCUs could engage in either direct or indirect leasing and either open-end or closed-end leasing. That is, an FCU could either purchase property from a vendor for the purpose of leasing such property to a member or purchase the lease and the leased property after the lease has been executed between the vendor and the member. Further, an FCU could either require a member to assume the risk and responsibility for any difference in the relied upon residual value and the actual value of the property at lease end or assume such risk itself.

After IRPS 83-3 was issued, NCUA received a number of inquiries regarding whether an FCU must own the leased property. NCUA responded through legal opinion letters that, in states requiring an entity engaged in leasing to be a licensed dealer, which involved posting a bond and complying with other state regulatory requirements, an FCU did not have to own the leased property. However, the FCU had to be named as the sole lienholder on the lease property and granted an unconditional, irrevocable power of attorney.

Thereafter, the leasing industry argued that irrespective of state limitations, an FCU should be able to

take a lien on the leased property instead of having to own the property. The industry stated that an FCU would be insulated from tort liability by not being the owner of the leased property and an FCU's member would have lower lease payments if the vendor was able to take advantage of certain tax benefits available only if the vendor retained ownership of the property. NCUA concluded in legal opinion letters, that although the direct and indirect lease financing arrangements described in the supplementary section of IRPS 83-3 would result in an FCU owning the leased property, the IRPS itself did not require such ownership. Thus, NCUA took the position that the purchase or assignment of a lease and the receipt of a lien on the leased property was a form of permissible indirect lease financing if an FCU was named as the sole lienholder on the lease property, was assigned all of the vendor's rights under the lease, and obtained an unconditional, irrevocable power of attorney.

The recent bankruptcy of a leasing company has brought to NCUA's attention the potential problems regarding the ownership of the leased property and the lease in indirect lease financing. In the bankruptcy case, the trustee has argued that the leasing company, not the FCU, owned the leases and the leased property. NCUA still is of the position that an FCU does not have to own the leased property since leasing is to be the functional equivalent of secured lending, and in secured lending, the member owns the property which is the security for the loan, not the FCU.

However, NCUA is concerned that an assignment of the rights under a lease is not the same as a full assignment of the lease, that is, ownership of the lease. Unless an FCU becomes owner of a lease, there is a legal question as to how the lease will be treated in the event of the bankruptcy of a vendor. Failure to receive a full assignment could result in a substantial loss to an FCU in the event of the bankruptcy of a vendor.

B. The Proposed Regulation

In drafting the proposed regulation, NCUA has chosen to use a plain English, question and answer format. Plain English is being promoted within the federal government as a means to increase regulatory comprehension and improve compliance among users of regulations by decreasing confusion and misunderstanding created by unclear standard regulatory language.

The proposed regulation adopts the leasing policy and requirements set forth in IRPS 83-3 although the

language and the format of the proposed regulation are different. In addition, the proposed rule specifically provides that an FCU does not have to own the leased property if an FCU obtains a full assignment of a lease, in other words becomes the owner of the lease, is named as sole lienholder on the property, and obtains an unconditional, irrevocable power of attorney.

C. Request for Comments

At this time, the NCUA Board invites the public to review the proposed regulation and requests comment on the use of the plain English format and the issues presented below. The questions below are intended to elicit comments on issues of concern; however, the list is not intended to be exclusive. The NCUA Board welcomes any and all relevant comments on leasing. Please remember that a comment that includes the reasoning or basis for a proposition likely will be more persuasive than a comment without supporting information.

Questions

1. Should an FCU be required to own the leased property?
2. If NCUA does not require an FCU to own the leased property, but permits it to be a first lienholder, should an FCU be required to obtain a power of attorney from the leasing company?
3. Should an FCU be required to receive a full assignment of the lease in an indirect lease financing arrangement?
4. Should NCUA raise the 25% residual value limit?
5. Should NCUA establish a minimum rating for insurance companies used in leasing arrangements? If so, what rating should be used?

Regulatory Procedures

Regulatory Flexibility Act

The NCUA Board certifies that the proposed regulation will not have a significant impact on a substantial number of small credit unions. Most small credit unions do not offer lease financing arrangements to its members. Accordingly, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The NCUA Board has determined that the requirement in § 714.5 that an FCU must obtain or have on file statistics documenting that a guarantor has the resources to meet a residual value guarantee constitutes a collection of information under the Paperwork Reduction Act. NCUA is submitting a copy of this proposed regulation to the Office of Management and Budget (OMB) for its review.

The proposed regulation requires an FCU to obtain a guarantee if it uses a residual value estimate that is greater than 25% of the value of the leased property. Residual value is the projected future value of leased property at lease end. A significant disparity in a residual value estimate and the actual value of a leased property at lease end can result in a loss to an FCU. The greater the residual value estimate used, the greater the potential for loss is for an FCU. For this reason, it is important that a residual value estimate greater than 25% is guaranteed and that the guarantor is financially able to meet the guarantee. The NCUA Board believes that the best way for an FCU to evaluate the creditworthiness and ability of a guarantor to meet the guarantee is to obtain and maintain documentation evidencing such financial ability.

The NCUA Board estimates that it will take an average of one to two hours to acquire, maintain, and evaluate such documentation. The NCUA Board estimates that approximately 750 FCUs are engaged in leasing, so that the total annual collection burden is estimated to be no more than 1500 hours.

The Paperwork Reduction Act of 1995 and OMB regulations require that the public be provided an opportunity to comment on information collection requirements, including an agency's estimate of the burden of the collection of information. The NCUA Board invites comment on: (1) whether the collection of information is necessary; (2) the accuracy of NCUA's estimate of the burden of collecting the information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of collection of information. Comments should be sent to: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, D.C. 20503; Attention: Alex T. Hunt, Desk Officer for NCUA. Please send NCUA a copy of any comments you submit to OMB.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The Proposed regulation only applies to federal credit unions. The NCUA Board has determined that the proposed regulation does not constitute a significant regulatory action for the purposes of the Executive Order.

List of Subjects in 12 CFR Part 714

Credit unions, Leasing.

By the National Credit Union Administration Board on October 22, 1998.
Becky Baker,
Secretary to the Board.

Accordingly, NCUA proposes to add Part 714 to read as follows:

PART 714—LEASING

Sec.

714.1 What does this part cover?

714.2 What are the permissible lease financing arrangements?

714.3 Must you own the leased property arrangement?

714.4 What are the lease requirements?

714.5 What is required if a residual value greater than 25% is used?

714.6 Who is responsible for the difference between the residual value estimate and the actual value of the leased property at lease end?

714.7 Are you required to retain salvage powers over the leased property?

714.8 What are the insurance requirements applicable to leasing?

714.9 What rate of interest may be charged under a lease?

714.10 When engaged in indirect leasing, must you comply with the purchase of eligible obligation rules set forth in § 701.23 of this chapter?

714.11 What other laws must you comply with when engaged in leasing?

Authority: 12 U.S.C. 1756, 1757, 1766, 1785, 1789.

§ 714.1 What does this part cover?

This part covers the standards and requirements that a federal credit union ("you") must follow when engaged in the lease financing of personal property.

§ 714.2 What are the permissible lease financing arrangements?

(a) *Direct leasing.* In direct leasing, you purchase personal property from a vendor, becoming the owner of the property at the request of your member, and then lease the property to that member.

(b) *Indirect leasing.* In indirect leasing, you purchase a lease and the leased property for the purpose of leasing such property to your member after the lease has been executed between a vendor and your member.

§ 714.3 Must you own the leased property?

You do not have to own the leased property if:

(a) You obtain a full assignment of the lease. A full assignment is the assignment of the rights, interests, obligations, and title in a lease to you, that is, you become the owner of the lease;

(b) You are named as the sole lienholder of the leased property; and

(c) You receive an unconditional, irrevocable power of attorney to transfer title in the property to yourself.

§ 714.4 What are the lease requirements?

(a) Your lease must be a net lease. In a net lease, your member assumes all the burdens of ownership including maintenance and repair, licensing and registration, and insurance;

(b) Your lease must be a full payout lease. In a full payout lease, you must recoup your entire investment in the leased property, amount financed, plus the cost of financing over the term of the lease; and (c) Your residual value estimate may not exceed 25% of the original cost of the leased property unless guaranteed. Residual value is the projected future value of the leased property at lease end. The residual value estimate must be reasonable in light of the nature of the leased property and all circumstances relevant to the leasing arrangement.

§ 714.5 What is required if a residual value greater than 25% is used?

You may use a residual greater than 25% of the original cost of the leased property if a financially capable party guarantees the full value of the property. The guarantor may be the manufacturer or an insurance company that has a nationally recognized industry rating of at least a B+. You must obtain or have on file statistics documenting that the guarantor has the resources to meet the guarantee.

§ 714.6 Who is responsible for the difference between the residual value estimate and the actual value of the leased property at lease end?

Either you or your member may be responsible for the difference in the residual value and the actual value. Thus, your lease may be either open-end or closed-end. In an open-end lease, your member assumes the risk and responsibility for any difference in the relied upon residual value and the actual value of the property at lease end. In a closed-end lease, you assume such risk.

§ 714.7 Are you required to retain salvage powers over the leased property?

You must retain salvage powers over the leased property. Salvage powers protect you from a loss and provide you with the power to take action if there is an unanticipated change in conditions that threatens your financial position by significantly increasing your exposure to risk. Salvage powers allow you:

(a) As the owner and lessor, to take reasonable and appropriate action to salvage or protect the value of the

property or your interests arising under the lease; or

(b) As the assignee of a vendor's interest in a lease, to become the owner and lessor of the leased property pursuant to your contractual rights, or take any reasonable and appropriate action to salvage or protect the value of the property or your interests arising under the lease.

§ 714.8 What are the insurance requirements applicable to leasing?

(a) You must maintain a contingent liability insurance policy with an endorsement for leasing or be named as the co-insured if you do not own the leased property. Contingent liability insurance protects you should you be sued as the owner of the leased property. You must use an insurance company with a nationally recognized industry rating of at least a B+.

(b) Your member must carry the normal liability or collateral protection insurance on the leased property. The insurance policy must acknowledge the property as leased and list you as the financier of the leased property.

§ 714.9 What rate of interest may be charged under a lease?

You may charge a rate of interest that is higher than the usury ceiling limit for credit unions set forth in § 701.21(c)(7)(ii)(B) of this chapter when engaged in leasing activities.

§ 714.10 When engaged in indirect leasing, must you comply with the purchase of eligible obligation rules set forth in § 701.23 of this chapter?

You may participate in an indirect leasing arrangement under your authority to make loans to members if:

(a) You review the lease and other documents to determine that the arrangement complies with your leasing policies; and (b) You receive a full assignment of the lease very soon after it is signed by your member and a vendor.

§ 714.11 What other laws must you comply with when engaged in leasing?

You are subject to the lending rules set forth in § 701.21 of this chapter, except as provided in § 714.9 of this part, and the Consumer Leasing Act, 15 U.S.C. § 1601, *et seq.*, and Regulation M, 12 CFR Part 213 implementing such Act.

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