# OPS NOTES

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## Topic: Multi-Featured Lending Programs

The National Credit Union Administration (NCUA) released a Letter to Federal Credit Unions 12-FCU-02 (Letter) in response to request for guidance. This Letter includes a Supervisory Letter that is instructive to credit unions regarding how examiners are expected to approach the issue.

Types of Multi-Featured Lending Programs

There are two types of multi-featured lending programs:

1. Multi-featured open-end lending (MFOEL) – MFOEL plans utilizing an umbrella loan agreement for a single account that can be accessed repeatedly via a number of sub-accounts established for different credit features. The plan as a whole, including all its sub-accounts, is designed to be treated as open-end credit. Examples of MFOEL include share overdrafts, unsecured lines of credit, share-secured lines of credit, vehicles, and home equity lines of credit.
2. Multi-featured lending (MFL) – MFL plans utilizing an umbrella loan agreement for a member's open-end lines of credit and closed-end loans.

Regulation Z Requirements

The definition of "open-end credit" under Regulation Z §1026.2(a)(20) is as follows:

> (20) *Open-end credit* means consumer credit extended by a creditor under a plan in which:
>
> > (i) The creditor reasonably contemplates repeated transactions;
> >
> > (ii) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and
> >
> > (iii) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

The Official Staff Interpretations to Regulation Z explains, essentially, that because the total amount of credit is provided at the outset and is occasionally replenished when earlier advances are repaid, creditors may only "occasionally and routinely verify credit information such as the consumer's continued income and employment status…but may **not** [Emphasis added] be done as a condition of granting a consumer's credit request for the particular advance under the

plan." In other words, the open-end plan must be underwritten at the time of application, and cannot be repeated when the consumer takes further advances from the plan.

However, as a safety and soundness issue, credit unions may question the value of collateral when granting an advance.

## BLENDED APPROACH OR MULTI-FEATURED LENDING (MFL)

Multi-featured lending (MFL) programs that utilize an umbrella loan agreement for a member's open-end lines of credit and closed-end loans, and have the following features:

- One master loan agreement is signed when the multi-featured plan is first established;
- Multiple sub-accounts with both open-end and closed-end credit features are added under the one master loan agreement; and
- For single-disbursement, non-replenishing closed-end sub-accounts (e.g., a vehicle loan), the member will be required to apply for and be approved for the advance. Specific advance requests are fully underwritten and the member receives the closed-end disclosures in accordance with Regulation Z §§1026.17 and 1026.18.

MFL programs are permissible so long as the credit union complies with the Regulation Z requirements under Subpart B for open-end credit and Subpart C, for each closed-end loan under the master plan.

### Policies and Procedures

Credit unions engaged in MFL must have policies and procedures that clearly differentiate the underwriting requirements for opening a MFL plan versus the verification requirements that may take place "occasionally or routinely."

Policies and procedures should contain the following information:

- The types of loan products it will include in the plan;
- The credit limits for each loan product within the plan;
- The type and extent of information that will be collected from applicants in order to establish creditworthiness and the baseline for verifying future advance requests;
- Sending an adverse action notice to applicants who are denied credit;
- Verifying a borrower's continued creditworthiness on an "occasional," ad hoc basis (i.e., outside the regular verification timetable on a one-time or extemporaneous basis), or "routinely," on a regular, periodic timetable (e.g., quarterly, every six months etc.); and
- Documentation for the reasons an occasional verification is performed in order to ensure it is not done in connection with an advance request.

## BEST PRACTICES

In complying with the open-end lending rules in Regulation Z, the Letter provides the following best practices to consider:

- Draft and approve policies and procedures that differentiate open-end lending from closed-end lending. This should include specific processes for opening MFOEL plans, performing "occasional or routine" verification, issuing advances within open-end policies, and establishing specific credit limits for each feature within the plan.

- Use legal counsel as warranted to review the credit union's policies, procedures, and documents for compliance with Regulation Z.
- Ensure your data processing provider can support the credit union's policies and procedures for MFOEL. Data processing systems must be able to identify members with MFOEL plans and send periodic statements appropriately.
- Ensure staff receives the necessary training. This includes training of staff beyond the lending department. For example, member service representatives and call center staff should be knowledgeable with MFOEL terms and processes.
- When MFOEL plans are secured by collateral such as a member's residence, it is still appropriate for credit unions to verify the collateral value with each advance.
- Portfolio credit scoring or "soft pulls" are appropriate if done on a routine, periodic or ad hoc basis for the entire MFOEL portfolio, but are not permissible in conjunction with a particular member advance that will be treated as open-end credit.
- After opening MFOEL plans, credit reports should be used on a routine, periodic or ad hoc basis to verify continued creditworthiness – not to underwrite an individual advance. Verification should not be specifically triggered by, or tied to, an advance request. For example, using credit report information to complete a debt-to-income ratio computation is impermissible if triggered by an advance request. Such computations may only be done on a periodic or ad hoc basis as part of a credit union's "occasional or routine" verification procedures.
- Credit unions should determine whether a particular advance is properly characterized as open-end or closed-end credit and provide the appropriate disclosures. Credit unions should use closed-end lending practices and disclosures when it is appropriate to perform underwriting at the time of the advance request. Examples of traditional MFOEL products where closed-end disclosures are generally more appropriate include vehicle-secured loans and large-balance unsecured loans.
- Credit unions may use a blended approach that uses a single master loan agreement for a borrower's open-end and closed-end loans, provided that appropriate disclosures are given.

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This edition of OPS NOTES was prepared by the Michigan Credit Union League.