Dear Board of Directors and Chief Executive Officer:

Credit unions that use a multi-featured open-end lending (MFOEL) plan to make various types of loans have asked NCUA for further guidance to interpret the latest rules issued by other federal regulatory agencies. The purpose of this letter is to update guidance to federal credit unions on multi-featured open-end lending\(^1\) and provide best practices for MFOEL plans used as single accounts with separate sub-accounts for different loan products.\(^2\)

This letter supersedes and replaces NCUA’s Letter to Federal Credit Unions 10-FCU-02, which contained NCUA’s previous guidance on this subject.

This letter also discusses a permissible blended approach to multi-featured lending (MFL).

In preparing this letter, NCUA consulted with the Consumer Financial Protection Bureau (CFPB) on the interpretation of Regulation Z as it relates to MFOEL.

NCUA is also issuing the attached Supervisory Letter to examiners (Appendix A) to address examination procedures and expectations regarding multi-featured lending programs from a safety and soundness standpoint.

---

\(^1\) Regulation Z defines “open-end credit” as consumer credit extended by a creditor under a plan in which (1) the creditor reasonably contemplates repeated transactions, (2) the creditor may impose a finance charge from time to time on an outstanding unpaid balance, and (3) 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, generally is made available to the extent that any outstanding balance is repaid. 12 C.F.R. §1026.2(a)(20).

\(^2\) Examples of common MFOEL products include share overdrafts, unsecured lines of credit, share-secured lines of credit, vehicles, and home equity lines of credit.
BACKGROUND

The Federal Reserve Board (FRB) issued changes to Regulation Z’s open-end credit rules in January 2009.3

The FRB issued a 2010 final rule which primarily focused on implementing the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009.4 That rule incorporated the MFOEL portions of the FRB’s January 2009 final rule.5

The FRB-issued changes to Regulation Z significantly altered the way financial institutions must support open-end credit.

As a result of this action, NCUA issued Letter to Federal Credit Unions 10-FCU-02 (Sept. 2010), advising federal credit unions using a multi-featured open-end lending product to review their policies and procedures to ensure they are in compliance with changes to Regulation Z that became effective July 1, 2010.

Rulemaking authority for Regulation Z transferred from the FRB to the CFPB on July 21, 2011.6

The CFPB recently issued an interim final rule republishing the FRB’s Regulation Z (and the accompanying official commentary) as CFPB’s new Regulation Z.7

---

3 74 Fed. Reg. 5244 (Jan. 29, 2009)
5 The provisions related to multi-featured open-end lending were first adopted in the Federal Reserve Board’s January 2009 rule. 74 Fed. Reg. 5244 (Jan. 29, 2009). The 2009 rule was withdrawn on the same day that the February 2010 rule was published. 75 Fed. Reg. 7925 (Feb. 22, 2010). The provisions related to MFOEL were republished in the February 2010 rule without restating the supplementary information related to MFOEL from the January 2009 rule.
6 Under section 1025 of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the CFPB has authority to examine for compliance with federal consumer financial laws, including the Truth in Lending Act, and to enforce those laws for federal and state-chartered credit unions with total assets of more than $10 billion. NCUA has enforcement authority for federal credit unions with total assets of $10 billion or less, while the Federal Trade Commission has enforcement authority for state-chartered credit unions (which it shares with the CFPB for state-chartered credit unions with total assets of more than $10 billion).
7 12 C.F.R. part 1026. The republished regulation incorporates only technical, formatting, and stylistic changes and does not impose any new substantive obligations on regulated entities. The technical changes reflect the transfer of authority to the CFPB and certain other technical amendments required by the Dodd-Frank Act. 76 Fed. Reg. 79768 (Dec. 22, 2011). To minimize confusion, the CFPB preserved the numbering system of the FRB’s Regulation Z, other than the new part number. The citations to Regulation Z included in this letter reflect the new numbering in the CFPB’s interim final rule.
WHAT THE CHANGES MEAN

The changes to the Official Staff Commentary in Regulation Z still permit MFOEL. However, the amended rule required changes to policies, procedures, and data processing systems in order to meet the revised guidance addressing MFOEL.\(^8\)

The FRB cautioned against improperly treating a series of closed-end credit transactions as though they were advanced under an open-end credit plan. Where each individual credit transaction is evaluated separately, they should be treated as closed-end extensions of credit.

Changes to the official staff commentary essentially mean credit unions offering MFOEL plans may “occasionally or routinely” verify credit information, but verification of credit information cannot be done “as a condition” of granting a new advance under the plan.\(^9\)

In other words, the underwriting of individual advances is not allowed for an extension treated as open-end credit under an MFOEL plan. Credit unions that wish to underwrite individual advances may do so, but such extensions of credit must be treated as closed-end with closed-end disclosures provided to the borrowers.

To assist federal credit unions in complying with the amended open-end lending rules in Regulation Z, this letter identifies best practices for MFOEL.

This letter also emphasizes the need to use the appropriate lending disclosures for the appropriate loan products. When a credit union’s safety and soundness requires that underwriting be performed for a particular loan product at the time funds are advanced, then the credit union should use closed-end products and provide the member with closed-end disclosures.

REQUIRED POLICIES AND PROCEDURES

A foundation of open-end lending is that consumers apply for credit only one time: at account opening. The changes to Regulation Z clarified that underwriting must take place only at the opening of an MFOEL plan. Credit unions using MFOEL plans are permitted to verify a person’s creditworthiness to ensure it has not deteriorated (and revise credit limits and terms accordingly), but they must not perform underwriting because a person has requested a particular advance that would be treated as open-end credit under the plan.

\(^8\) 74 Fed. Reg. at 5258-61, 5453-54. For additional guidance, federal credit unions can refer to the discussion of open-end credit in the preamble to the FRB’s January 2009 Regulation Z rule. 74 Fed. Reg. 5244.

Credit unions engaged in MFOEL must have policies and procedures that clearly differentiate the underwriting requirements for opening an MFOEL plan versus the verification requirements that may take place “occasionally or routinely.”

For example, credit unions may verify credit information on a periodic or ad hoc basis, but such verification cannot be done in connection with, or triggered by, an individual advance request or by a certain type of advance request.

**MFOEL Policies for Opening Plans:** Credit unions engaged in MFOEL must gather enough information about member-borrowers at the opening of a plan in order to establish creditworthiness. Each credit union must determine the type and extent of information that will be collected. This information will be used as a baseline to verify the future creditworthiness of members. If creditworthiness cannot be established with the information provided at account opening and the plan is denied, an adverse action notice must be sent to the member.

**MFOEL Policies for Advance Requests:** Once an MFOEL plan is established, credit unions may verify a member’s continued creditworthiness “occasionally” on a limited, ad hoc basis, or “routinely” on a regular, periodic timetable (e.g., every six months) to determine whether a borrower continues to meet the credit union’s credit standards by reviewing a subset of the information collected at the plan’s opening. This verification must not be treated as an opportunity to underwrite an individual advance request. This means verification of credit information, even if it involves something short of traditional underwriting, cannot be done in connection with, or triggered by, a member’s advance request. Credit unions cannot make members “apply” for an advance, and verification of credit information cannot be triggered by a particular advance request or a certain type of advance request if that advance will be treated as open-end credit. In its preamble to the final regulation, the FRB clarified that a creditor cannot underwrite individual advances in an open-end plan:

> The [Federal Reserve] Board believes that underwriting of individual advances exceeds the scope of the verification contemplated by the statute and is inconsistent with the definition of open-end credit. The Board believes that the rule does not undermine safety and soundness lending practices, but simply clarifies that certain types of advances for which underwriting is done must be treated as closed-end credit with closed-end disclosures provided to the consumer.\(^\text{10}\)

A properly designed verification process will confirm the member’s ongoing creditworthiness in a manner that is consistent with the credit union’s safety and soundness. The purpose of occasional or routine verification of credit information is to ensure the member’s creditworthiness has not deteriorated; it may not be based on advance requests.

\(^{10}\) 74 Fed. Reg. at 5260.
A credit union cannot use underwriting criteria such as a debt-to-income ratio or a credit score after the opening of an MFOEL plan in considering whether to grant an advance under the plan.

It is permissible for a credit union to adopt a policy with neutral criteria that establishes the review of current credit reports, credit scores, debt ratio, and income information on a reasonable periodic timetable (e.g., every six months) or on a limited ad hoc basis provided that such review is not in connection with, or triggered by, a member’s advance request under an open-end credit plan.

For example, it would be impermissible for a credit union to review a credit report or ask the member to verify income as conditions of providing an advance.

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

In response to the Regulation Z amendments, some federal credit unions have utilized a blended approach that uses an umbrella loan agreement for a member’s open-end lines of credit and closed-end loans. The blended approach is not an MFOEL plan. It is more accurately described as a multi-featured lending plan and consists of 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; Open-end disclosures are provided to the member for revolving, replenishing open-end sub-accounts, in accordance with 12 C.F.R. §§ 1026.5 and 1026.6. Once the line of credit is established, the credit union cannot underwrite a particular advance but it may occasionally or routinely verify that the member’s credit standing has not deteriorated; 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 12 C.F.R. §§1026.17 and 1026.18. For example, on advances secured by collateral other than real property, the disclosures are given prior to the time the funds are disbursed, at which point the member is obligated on the loan (i.e., consummation).

Use of a blended approach that combines both open-end and closed-end credit is consistent with Regulation Z, provided the credit union complies with the requirements under 12 C.F.R. part 1026, subpart B for open-end credit and 12
C.F.R. part 1026, subpart C, for each closed-end loan transaction under the master plan.

Credit unions using either an MFOEL plan or the MFL plan must ensure their policies and procedures are in compliance with the requirements of Regulation Z.

BEST PRACTICES

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

- 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.

If you have questions concerning this Letter to Federal Credit Unions, please contact your Regional Office or NCUA examiner.

Our intent is not to discourage underwriting of new loans under MFOEL plans, but to ensure that credit unions provide the required consumer disclosures. By following the best practices and/or the blended approach described in this letter, credit unions can continue to provide multi-featured lending in the best interests of members.

Sincerely,

/s/

Debbie Matz
Chairman

Enclosure