Supervisory Letter

Supervision Considerations for Multi-Featured Lending Programs

Credit unions have a long-standing history of using multi-featured lending programs to meet their members' needs and to diversify their loan portfolios. This supervisory letter discusses examination procedures and expectations from a safety and soundness standpoint. It also provides guidance on risk management and compliance practices relative to these lending programs.

There are two types of multi-featured lending programs used within the credit union industry:

1. Multi-featured open-end lending (MFOEL) – MFOEL plans utilize 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.
2. Multi-featured lending (MFL) – MFL plans utilize an umbrella loan agreement for a member's open-end lines of credit and closed-end loans.

MFOEL

Credit unions using MFOEL plans are permitted to occasionally or routinely verify a member-borrower's creditworthiness to ensure it has not deteriorated (and revise credit limits and terms accordingly), but they must not perform underwriting or credit verification because a member-borrower has requested a particular advance that would be treated as open-end credit under the plan.

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

For example, examiners may encounter credit unions that utilize verification matrixes in their MFOEL policies to determine what subset of a member-borrower's credit information to verify based on various "triggers," such as an advance request made a number of years since the member's last advance, or a request for an unsecured large-dollar loan. Such matrixes are impermissible for a MFOEL policy because, under Regulation Z, no verification of credit information can be done <u>in connection with, or</u>

triggered by, an individual advance request if that advance is treated as open-end credit.

What are the steps of underwriting?

Credit unions engaged in MFOEL must gather enough information about member-borrowers at the opening of a MFOEL plan to establish creditworthiness for all advances treated as open-end credit under the plan. Each credit union must determine the type and extent of information it will collect for the underwriting process. This information will be used to determine the member-borrower's creditworthiness for any future advance requests made subsequent to the plan opening. Information obtained through the underwriting process will also be used as a baseline to verify, on a routine or occasional basis, a member-borrower's continued creditworthiness. Credit unions must not perform underwriting as a condition of granting an individual advance that would be treated as open-end credit under the plan. Credit unions should clearly define the underwriting criteria in their MFOEL policy.

What steps may a credit union take to verify the members' continued creditworthiness?

A properly designed verification process will confirm the member-borrower's ongoing creditworthiness in a manner that is consistent with the credit union's safety and soundness. The purpose of the occasional or routine verification of credit information is to ensure the member-borrower's creditworthiness has not deteriorated; it may not be used to subject an advance request to a new credit determination.

Each credit union must determine the type and extent of information it will obtain and evaluate to confirm a member's continued creditworthiness. Credit unions may perform a routine or occasional verification of creditworthiness that is as robust as what occurs at the underwriting stage, or they may choose to verify a more limited subset of the information collected at account opening. Verification of creditworthiness, however, must not be done in connection with, or triggered by, an individual advance request if that advance is to be treated as open-end credit under the plan. Examiners should expect credit unions to clearly define the verification criteria they will use in their MFOEL policy.

What is considered routine verification?

Routine verification occurs on a regular, periodic timetable (quarterly, every six months, etc.) established by the credit union and is used to determine whether a member-borrower continues to meet the credit union's credit standards by reviewing all or portions of the information collected at the plan's opening. The credit union's policy should clearly establish the schedule or time interval it intends to use for the routine verification process and examiners should expect to see an established practice of routine verification.

What is considered occasional verification?

Occasional verification occurs on a limited, ad hoc basis that is outside the regular verification timetable on a one-time or extemporaneous basis. This verification cannot be made in connection with, or triggered by, a member-borrower's advance request under an open-end credit plan. It is not permissible for a credit union to perform any type of underwriting or verification procedures as conditions of providing an advance under an open-end credit plan, even though the request for an advance or a certain type of advance only occurs on an occasional basis. For example, members generally request a car loan every few years. While this particular type of request is only made occasionally, it is impermissible to perform underwriting or verification procedures in connection with or triggered by this occasional loan request under an open-end plan.

As stated earlier, examiners should expect credit unions to have a well-defined and established process to periodically or routinely verify a member's continued creditworthiness under these plans. While Regulation Z permits occasional verification of a member-borrower's continued creditworthiness, it should not be the norm. Credit unions should document the reasons for any occasional verification performed. Examiners reviewing MFOEL files should look for anomalies for verifications performed outside the established routine verification process to ensure the verification was not triggered by, or in connection with, an advance request.

If an occasional or routine verification appears to occur concurrently with an advance request, the credit union should be able to demonstrate that the verification was performed within the established verification process.

May auto loans be granted under a MFOEL plan?
Yes, auto loans may be granted under a MFOEL plan provided the auto loan advance request does not trigger underwriting or verification procedures as a condition of granting the loan. If the credit union wishes to perform underwriting or verification of creditworthiness in connection with the request for an auto loan, then the loan must be treated as a closed-end loan with the proper closed-end disclosures provided to the member.

Is the credit union required to perform a verification of the member's credit worthiness?
Regulation Z permits, but does not require, routine or occasional verification of a member-borrower's continued credit worthiness. As a best practice and a matter of safety and soundness, however, credit unions should routinely verify a member-borrower's creditworthiness to ensure it has not deteriorated (and revise the member-borrower's credit limits and terms accordingly). It is up to the credit union to establish a schedule or time interval it intends to use for the routine verification process in its MFOEL policy.

May a credit union verify the value of the collateral under a MFOEL plan?
Yes, as a safety and soundness issue it is appropriate and prudent for a credit union to question the value of collateral when granting the advance.

May a credit union use a blended approach that combines both open-end and closed-end credit?
Yes, this is called a multi-featured lending (MFL) plan and is consistent with Regulation Z, provided the credit union complies with the requirements under 12 C.F.R. pt. 1026, Subpart B for open-end credit and 12 C.F.R. pt. 1026, Subpart C, for each closed-end loan under the master plan.

A MFL plan features one master agreement with multiple subaccounts with both open-end and closed-end credit features. Open-end disclosures are provided to the member for revolving, replenishing open-end subaccounts, 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. For single-disbursement, nonreplenishing closed-end subaccounts (e.g., vehicle loan), the member-borrower 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.

Policies and procedures

Successful lending programs rely on well-developed policies and practices. Regardless of whether the credit union is using a MFOEL or a MFL plan, the loan policy should clearly establish:

- The procedures the credit union will follow when performing underwriting under the program;
- The procedures the credit union will use when performing an occasional or routine verification;
- The timing of routine verifications (annually, biennially, quarterly, staggered, etc.);
- The types of loan products it will include in the plan; and
- The credit limits for each loan product within the plan.

As a safety and soundness issue, examiners should expect to see periodic verifications of the creditworthiness of the member-borrowers in the credit union's MFOEL program. The definition of periodic will be defined by the credit union and the credit union should show an established process of verification.

Conclusion

Many credit unions use multi-featured lending plans as a flexible, timely and efficient way for their member-borrowers to obtain financing. Examiners should not discourage the use of MFOEL or MFL programs, but should ensure credit unions understand and comply with the regulatory requirements regarding multi-featured lending, as well as providing for the safety and soundness of the credit union.