



National Credit Union Administration
Office of Examination and Insurance

July 28, 2023

SENT BY FEDERAL EXPRESS AND ZIXMAIL

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Dear XXXX:

RE: XXXX Material Supervisory Determination Appeal

On June 30, 2023, you filed a request for reconsideration by the Director of the Office of Examination and Insurance (E&I) on behalf of XXXX (XXXX) September 30, 2022, exam report. E&I received your request on July 3, 2023. On July 11, 2023, E&I requested additional information, which was received on July 14, 2023.

You requested a review of the material supervisory determination made on June 1, 2023, by Regional Director XXXX. You filed this reconsideration request pursuant to 12 CFR § 746.106, which allows a credit union to seek my review of a written material supervisory determination by a program office. Specifically, you sought my review of the XXXX Region's determination regarding an insured credit union's compliance with a federal consumer financial law (12 CFR § 746.103(a)(4)). More specifically, your request for reconsideration involves the Document of Resolution (DOR) item cited in the September 30, 2022, exam report pertaining to the credit union's compliance with 12 CFR § 1026 Truth in Lending (Regulation Z) involving the credit union's home improvement loan program and whether the home improvement vendor-paid fee is considered a finance charge.

As discussed more fully below, I concur with the XXXX Region Regional Director that the vendor-paid fees are finance charges and are therefore subject to appropriate disclosure to the borrower in accordance with Regulation Z.

Background

XXXX has a home improvement loan program. According to the credit union's request for reconsideration, this home improvement loan program consists of customers seeking improvements to their homes and was implemented to accommodate members' needs in an area with a high volume of older homes. The financing process involves local vendors providing the home improvement services to the customer and connecting the customer to the credit union for financing of the home improvement costs with a zero-percent interest loan. The transaction is similar to an indirect lending relationship where the customers use a portal at the home improvement vendor's office to submit their financial information to the credit union, and the credit union underwrites and decisions the borrowers' credit eligibility. The credit union states the home improvement vendor charges the same price for services whether the customer pays

cash for the improvements or finances the home improvements. The credit union further states that the vendor pays the credit union a fee for financing the improvements which allows the customer to obtain a zero-percent interest rate for the financing.

The examiners issued a DOR at the September 30, 2022, examination citing noncompliance with Regulation Z, concluding the vendor-paid fee is financed by the borrower and therefore qualifies as a borrower-paid finance charge.

Discussion

Pursuant to the NCUA's regulations, 12 CFR § 746.106, the Director of E&I has jurisdiction to review a program office's material supervisory determination if the request for review was preceded by a request for reconsideration with the program office and filed within 30 days of a response from the program office. The NCUA's regulations define a "material supervisory determination" as a written decision by a program office that may significantly affect the capital, earnings, operating flexibility, or that may otherwise affect the nature or level of supervisory oversight of an insured credit union (12 CFR § 746.103(a)). Your request for review was timely and met the definition of a material supervisory determination.

Following the receipt of your request, my staff and I reviewed the information provided, as well as additional information we requested from the Region and the credit union. My staff and I also discussed relevant law and agency guidelines with the NCUA's Office of General Counsel and relevant NCUA subject matter experts.

The determination provided below is the result of our review of documentation and communications with parties involved (credit union, Region, etc.). Unless otherwise specified, all information is as of June 30, 2023, the date the request for reconsideration was filed.

Regulation Z – Finance Charge

12 CFR § 1026.4 defines a "finance charge" as a cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

The credit union states that the vendor-paid fee is not a finance charge because the fees are not payable directly or indirectly by the consumer. The credit union further states the fees are paid solely by the home improvement vendors as "non-creditor sellers" to reduce the interest rate to zero and therefore constitute seller's points, which are expressly excluded from the finance charge under Regulation Z (12 CFR § 1026.4(c)(5)). The credit union also provides an alternative that if the home improvement vendors are "seller-creditors" and therefore, the fees paid by the vendors constitute a discount on a credit obligation, the fees are not finance charges because these fees are not separately imposed on the consumer.

My staff's review of the request for reconsideration did not consider the technical definitions of a non-creditor seller and seller-creditor or whether these home improvement vendors qualify as either. The XXXX Region's appeal decision discussed the technical differences between these roles. Instead, my staff's review focused solely on the definition of a finance charge, the credit union's description of the home improvement transactions, and the documentation provided by the credit union that supports a sample transaction (vendor invoice, Truth in Lending disclosure, and general ledger entries). My staff's review is further supported by the Truth in Lending review performed by the XXXX Region examiners in conjunction with the September 30, 2022, exam.

The credit union provided a sample transaction in the appendices that accompanied the request for reconsideration. My staff requested additional information from the credit union to further support this transaction. This transaction and the supporting documentation mirror the information that was provided to examiners in conjunction with the September 30, 2022, exam.

My staff noted that while it may be the credit union's intent to provide a zero-percent interest financing to the home improvement loan borrower and for the vendor fee to be paid by the vendor, not the borrower, the credit union's accounting for the transaction and the TILA disclosures do not support the credit union's intent for a zero-interest financing. Instead, the credit union's records indicate the vendor fee is being paid by the borrower as part of the total amount financed.

Our review concluded that the vendor fee is considered a finance charge because the disclosure information and supporting general ledger entries provided by the credit union, both during this request for consideration and the exam, indicate this fee is being financed by the borrower in the disclosed total amount financed. Therefore, using this disclosure, the borrower is paying this fee, not the vendor. In the event the credit union's intent of this loan program is to provide zero-percent interest financing to the borrower for home improvements, the credit union should obtain guidance from a Certified Public Accountant on the proper TILA disclosures and accounting for these transactions in the general ledger.

My staff did not consider whether these vendor fees would qualify as seller's points because the credit union's disclosures indicate the borrower is financing these fees. As stated in this determination, it may be the credit union's intent to reduce the interest rate to zero by accepting a fee paid by the vendor (net of remittance), but the disclosures themselves do not reflect this intention.

Document of Resolution

The credit union's request for reconsideration disputes the language in the DOR, stating the vendors charge the same price to the consumer whether the consumer pays in cash or finances the purchase. The credit union says the XXXX Region did not disagree with these facts but did not appear to have considered these facts in its determination.

The disputed language appears to reference the first and second sentence in the DOR – “materially violated Regulation Z” “causing substantive harm to your members”. My staff’s review of this indicates the XXXX Region did in fact consider the statement that the vendor charges the same amount whether the transaction is paid in cash or financed. NCUA is not disputing that the credit union is providing a needed service to the members by offering home improvement lending in a territory that encompasses older homes with the intent to charge the borrower a zero-interest rate loan, nor is NCUA disputing that the vendors would charge similar rates for similar improvements regardless of the type of payment or financing. The subject statements instead refer to the credit union’s failure to properly disclose to the borrower the method by which it intended for these transactions to be zero percent financed. As noted in the above section, the disclosure information indicates the vendor fee is considered a finance charge because, based on the credit union’s disclosures and accounting, this vendor fee is financed by the borrower and thus is paid by the borrower – even if that was not the credit union’s true intention. The inappropriate accounting and disclosure of these transactions therefore materially violates Regulation Z and causes substantial harm to your members.

The credit union did not dispute the other DOR item pertaining to Revenue Recognition of the vendor fees. The DOR states the credit union plans to obtain an accounting opinion on the revenue recognition for the home improvement loan program. The credit union obtained an accounting opinion from XXXX dated May 31, 2023, which states *the appropriate application of GAAP to these transactions would include offsetting direct loan costs against loan origination fees for each loan and deferring the remaining loan origination fee revenue over the life of the loan without regard to a minimum dollar amount threshold.*

This accounting opinion also described the transaction process for the home improvement loan program. More specifically, the accounting opinion referred to the subject vendor fee as a “loan origination fee” that “is calculated at 5%, 7%, or 9% of the total loan balance depending on the loan amount and term.” The opinion further states “XXXX remits the funds to the contractor while withholding the total loan origination fee.” This statement supports the credit union’s implied intention to allow the vendor to absorb the cost of the transaction, but the credit union’s disclosures and accounting do not reflect this intended practice.

Final Determination

Based on the information outlined above, I concur with the XXXX Region Regional Director that the vendor fees are finance charges and are therefore subject to appropriate disclosure to the borrower in accordance with Regulation Z.

The above discussion establishes NCUA’s determination that the vendor fees are considered finance charges in accordance with Regulation Z. We arrived at this determination due to the credit union’s internal TILA disclosures showing the vendor fee is included in the amount financed by the borrower, and therefore the borrower is paying these fees.

Pursuant to the NCUA’s regulations, 12 CFR § 746.107, you may appeal this decision to the Supervisory Review Committee within 30 calendar days of receipt of this letter. Such an

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appeal must follow the requirements of the regulation and must be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428. Please refer to § 746.107 of the NCUA's regulations for additional information regarding the required contents of an appeal to the Supervisory Review Committee.

Sincerely,

Kelly Lay, Director
Office of Examination and Insurance

cc: Attorney XXXX
XXXX Region Mail
RD XXXX
Board Secretary XXXX