

# The Path to Regulation Z Compliance



Common Purpose. Uncommon Commitment.

July 27, 2009

**TO:** LOANLINER operations  
CUNA Mutual sales  
Data processors and loan origination system providers  
LOANLINER customers  
State credit union leagues

## **RE: The Path to Regulation Z Compliance**

Regulatory changes have been coming at record pace. Recent modifications to Regulation Z have been fast, furious and frequently hard to decipher. Credit unions need to remain vigilant to address compliance requirements for three upcoming key dates:

- August 20, 2009: Amendments to Regulation Z require a financial institution to mail or deliver a periodic statement 21 days before deeming a payment late for any reason. This applies to **ALL** open-end plans, including credit cards, HELOC's, and MFOEL plans
- February 22, 2010: Amendments to Regulation Z requiring specific, additional disclosures for **ALL** open-end plans
- July 1, 2010: Credit card changes and additional requirements affecting certain open-end lending plans, including multi-featured, open-end lending (MFOEL) plans

Credit unions need to understand requirements for each date and build implementation plans for their operations, for working with data processors, and for member notifications of changes where necessary. Due to the short period of time to comply with the regulation, this update focuses on the requirements for the **August 20 date only**. The Federal Reserve Board (FRB) has published detailed rules, including regarding the 21 day rule. This document describes what appear to be the most viable solutions emerging for compliance with the August 20<sup>th</sup>, 2009, requirements. It summarizes our analysis and hundreds of discussions we've had with credit unions, data processors, trade associations and others.

As always, LOANLINER compliance experts are available to answer your questions. Call 800.356.5012, option 2. Additional information regarding the February 22, 2010 compliance date will soon be forthcoming as preparations will need to begin shortly. And, a full set of tools and information for the July 1, 2010 compliance date is available at [www.loanliner.com/regz](http://www.loanliner.com/regz)

### **August 20 Requirements**

The FRB requires all financial institutions, including credit unions, to provide customers/members a periodic statement 21 days before a payment can be deemed late for any reason.

### **Viable Alternatives**

The following options appear to be emerging as the most common, viable and pragmatic approaches to meeting the requirements. (Note: These options assume the credit union provides monthly statements. If a credit union wants the right in the future to deem a payment to be late for any reason, they must provide a monthly periodic statement.)

1. Maintain current statement schedule adding payment or other information where necessary, and adjust loan due dates for loans not meeting the 21-day requirement

- a. Move your borrower's due dates for all open-end lending products (HELOCs, LOCs, overdraft line of credit, and MFOEL) to a date at least 21 days after you mail or deliver a periodic statement. Weekend days and holidays count when calculating the 21-day period between the mailing or delivering of the statement and the due date.
  - b. Work with your data processor or in-house resources to ensure your statements include all loan information as required in section 226.7 of Regulation Z (pages 5409-5411), including upcoming loan payment due dates.
  - c. For each open-end lending plan the member must be mailed or delivered a statement that includes a due date. A single, consolidated statement that includes share, share draft, and certificate accounts is permissible.
  - d. Continue allowing members to make payments based on their current payment schedule. Payment schedules may differ from due dates (ie: members who pay weekly, bi-weekly or semi-monthly). Depending on timing, as you implement your solution, you may have a "catch-up" month in which you may not be able to consider payments late for any reason.
  - e. Communicate in writing any changes in payment schedules and/or due dates to your members as appropriate. Discuss any change in terms with your legal counsel.
2. Change periodic statement date(s) and keep due dates and payment dates the same
    - a. Establish new periodic statement dates for each open-end account or unique sub-account such that the statements are mailed or delivered at least 21 days before each account's due date. Weekend days and holidays count when calculating the 21-day period between mailing or delivery of the statement and the due date.
    - b. Work with your data processor or in-house resources to ensure your statements include all loan information as required in section 226.7 of Regulation Z, including upcoming loan payment due dates.
    - c. Communicate as appropriate to help your members understand any changes in the number of and timing of statements.

#### **Steps to Take Before August 20, 2009 Compliance Date**

1. Determine which of the above three alternatives (or potentially other alternatives that may emerge) best fits your operation.
2. Seek the advice of your own counsel to determine if there are any contract issues relating to your approach and related to your particular situation.
3. Work with your data processor or in-house resources to implement your solution as needed. For example, we understand many credit unions may need to add loan due dates to their statements.
4. If you choose to adjust due dates, this may require you to change the coding of that loan on your system. Be sure to also consider related processes that could be affected by changing the due date. For example, this may have implication on automated late notice communications or other collection-related processes scheduled to occur.
5. Communicate any changes with your members as appropriate.

## FAQ's and Myth Debunking

1. **What is CUNA Mutual doing to address these issues?** CUNA Mutual is expending significant resources in support of credit union lending, including:
  - a. Working aggressively with CUNA & Affiliates and NAFCU and various Leagues to pursue any potential legislative solutions that may be available
  - b. Collaborating with industry groups:
    - i. League Compliance professionals
    - ii. CUNA's Lending Council's Regulatory/Compliance Committee
  - c. Directly engaging data processors on these compliance issues
  - d. Providing compliance input as these groups are assessing compliance requirements and exploring pragmatic solutions
  - e. Through communications such as this, we will serve as a clearinghouse for ideas, convey any additional analysis we become aware of, and continue to provide answers to frequently asked questions (FAQs).
2. **What do I do with payments that are scheduled for more often than once a month (ie: weekly or bi-weekly)?** The critical date is the "due date", no matter when a member makes a payment. Based on which option you choose from above, work with your operations department to ensure payments received are credited on time and any subsequent processes are appropriately triggered off the (monthly) due date.
3. **Will coupon books suffice as providing due date(s)?** No. A due date must appear on a periodic statement. A periodic statement contains specific disclosure requirements as described in Section 226.7 of Regulation Z that are likely more extensive than what appears in a coupon book. In order to meet the requirements, you must mail or deliver a "periodic statement" at least 21 days before due date(s).
4. **If I have not given 21 days notice before due date, can I wait to charge or waive a late fee until 21 days after the statement is mailed?** No. The regulation is based on the due date, not the date you'd charge a late fee. You must give members 21 days from the date the statement is mailed or delivered until the due date to deem them to be late for any reason.
5. **Won't I be OK if I simply document by the compliance date what I'm going to do to comply?** No. You're either in compliance, or you're not.
6. **What's the difference between a grace period and courtesy period?** They are defined in the regulation as two separate and distinct terms. The regulation states "grace period means a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate." 226.5 (b)(2)(ii). The regulation states, "courtesy period is an additional period of time after the contractual due date during which a late payment fee will not be assessed." 226.5-(b)(2)(ii)-3.-i. The 21-day notice provision applies to due dates and grace periods, not courtesy periods.
7. **Can I simply send a change in terms to move existing open-end loans to closed-end?** No. You've contractually agreed to provide these open-end accounts to your members. To convert to a closed end agreement, different disclosures and new loan documents must be provided amounting in essence to a refinancing of the loan. Your members must agree to terms by signing new documents prior to consummation. If any member does not agree to a change in terms, you must keep the open-end account available to them, thus requiring a need to comply with the new regulation. Additionally, refinancing these advances may affect the status of your lien position.
8. **Won't it be easier for us to just do closed-end loans?** Not necessarily. This is a complex decision. Because you must comply with the regulation for all remaining open-end products (such as overdraft lines of credit, open-end advances, HELOC's and other lines of credit), doing closed end loans prospectively

will require you to manage two separate and distinct lending systems concurrently. Further, as long as open-end loans remain outstanding, you will still need to provide required disclosures for these loans potentially well into the future. Finally, remember why you went to open-end lending in the first place. For many credit unions this has included advantages such as a superior member experience and convenience, reduced costs, avoiding increased staffing for in-branch loan closings, and ultimately more loans and fee income from broader member relationships. Changing systems requires a conversion that includes process changes, staff training, new documents, etc.

9. **Do my members need to agree to a change in their due date(s)?** We believe in most cases they do not, but we advise you to speak with your counsel to determine any contract issues in your particular situation.
10. **Can't I simply waive late fees?** This would only make you partially compliant with the regulation. You can't consider payments late for any reason (Regulation Z page 68) unless you provide 21 days notice. This includes increasing annual percentage rate as a penalty, reporting them to a credit reporting agency or any collection processes up to and including repossession.
11. **Does this apply to all open-end lending?** Yes, it applies to all open-end products such as lines of credit, overdraft protection, HELOC's, MFOEL and credit cards.
12. **Does it matter whether I send my statements electronically or by paper?** No. There is no distinction cited in the regulation for alternate forms of delivery.
13. **Are there any document changes related to the August 20 compliance date?** No.
14. **Can I change HELOC due dates?** Yes. The commentary to Regulation Z states that changing a due date is considered an insignificant change. 226.5b(f)(3)(v) Confer with counsel for any contract issues should you make this decision.
15. **What if I simply ignore this and see what others do?** You will be in violation of the regulation and subject to typical compliance and penalty exposures.
16. **How do I establish due dates for new loans in the future?** To be in compliance with the notice requirements, the first due date must be at least 21 days after the next periodic statement. If you send statements on the 2<sup>nd</sup> of each month, this would suggest establishing due dates on new advances after the 25<sup>th</sup> of the month
17. **What does "interim final rule" mean?** An interim final rule is one that is published without comment period. The FRB may issue final rules at any time that could offer a comment period and potential opportunity for change in the regulation.
18. **We provide quarterly statements to our members with open-end plans. We do not send a bill. Is the rumor true that I'm not in compliance with Reg Z?** This rumor is false. The current rules provide that if you do not send a bill, you may send "statements quarterly." After August 20, 2009 we believe the requirements for 21 day notice will pragmatically cause credit unions to send monthly statements in most cases.
19. **I've heard rumors that I'm out of compliance because I have not been sending my periodic statements 14 days before any grace period. Any truth here?** This rumor is also false. You were only required to send a periodic statement 14 days before any grace period if you had a program whereby a member could avoid paying finance charges by paying within the grace period. For almost all non-credit card accounts in credit unions, no grace period was provided, so the 14 day rule did not apply. (Note: the grace period rule will be moved for 14 days to 21 days, effective 8/20/2009).

**20. Are there any additional pending regulations forthcoming?** The pace and activity continues to increase. Proposed new rules for HELOC and close end loans were released for comment on July 23, 2009.