LOANLINER®
The ABCs of Open-End Lending

This document is intended to provide general information about the subject matter covered. It should not be substituted for professional legal advice. If legal advice is required, you should consult your attorney.
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1. Why is Open-End Credit Legal?

The Truth in Lending Act and Regulation Z govern lending disclosures. There are two types of credit—open-end credit and closed-end credit. Credit unions may legally do consumer lending as a closed-end loan or under an open-end credit plan. The disclosures for each type of lending are quite different. For your easy reference, applicable sections of Reg. Z are provided to explain the disclosure requirements.

Regulation Z defines open-end credit in Reg. Z section 226.2(a)(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 Commentary (hereinafter referred to as "Commentary") explains in more detail what is required by Regulation Z. Reading and understanding the Commentary is essential to understanding open-end credit. In this section, the actual text of the Commentary is italicized.

In order to be considered open-end credit, the credit must be extended under a plan and must meet all 3 criteria of the above definition. LOANLINER® Lending Systems provides a plan which meets all 3 criteria.

THERE MUST BE A PLAN

COMMENTARY - Section 226.2(a)(20)-2

Existence of a plan. The definition requires that there be a plan, which connotes a contractual arrangement between the creditor and the consumer. Some creditors offer programs containing a number of different credit features. The consumer has a single account with the institution that can be accessed repeatedly via a number of subaccounts established for the different program features and rate structures. Some features of the program might be used repeatedly (for example, an overdraft line), while others might be used infrequently (such as the part of the credit line available for secured credit). If the program as a whole is subject to prescribed terms and otherwise meets the definition of open-end credit, such a program would be considered a single, multifeatured plan.

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- The Credit Agreement and Addendum is the contractual arrangement.
- Each subaccount is a different program feature.
- Each subaccount has a different rate.
- First paragraph of the Credit Agreement refers to the documents as the “Plan.”
- Not all subaccounts under a plan have to be used repeatedly or at all.
- Many LOANLINER® Plans include secured credit features, which may be used infrequently.
- The LOANLINER® Plan, as a whole, meets the definition.
The Credit Union Must Reasonably Contemplate Repeated Transactions

COMMENTARY - Section 226.2(a)(20)-3

Repeated transactions. Under this criterion, the creditor must reasonably contemplate repeated transactions. This means that the credit plan must be usable from time to time and the creditor must legitimately expect that there will be repeat business rather than a one-time credit extension. The creditor must expect repeated dealings with consumers under the credit plan as a whole and need not believe a consumer will reuse a particular feature of the plan. The determination of whether a creditor can reasonably contemplate repeated transactions requires an objective analysis. Information that much of the creditor’s customer base with accounts under the plan make repeated transactions over some period of time is relevant to the determination, particularly when the plan is opened primarily for the financing of infrequently purchased products or services. A standard based on reasonable belief by a creditor necessarily includes some margin for judgmental error. The fact that particular consumers do not return for further credit extensions does not prevent a plan from having been properly characterized as open-end. For example, if much of the customer base of a clothing store makes repeat purchases, the fact that some consumers use the plan only once would not affect the characterization of the store’s plan as open-end credit. The criterion regarding repeated transactions is a question of fact to be decided in the context of the creditor’s type of business and the creditor’s relationship with its customers. For example:

A. It would be more reasonable for a thrift institution chartered for the benefit of its members to contemplate repeated transactions with a member than for a seller of aluminum siding to make the same assumption about its customers.

B. It would be more reasonable for a financial institution to make advances from a line of credit for the purchase of an automobile than for an automobile dealer to sell a car under an open-end plan.

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- It is the credit union’s expectation that the plan will be reused, not the member’s actual usage.
- Credit unions have a unique relationship with “MEMBERS” which almost assumes that repeated dealings can be expected.
- A “thrift institution chartered for the benefit of its members” is a credit union.
- The commentary specifically mentions the ability to do automobile lending under an open-end credit plan.
A Finance Charge May Be Computed and Imposed From Time to Time on the Outstanding Balance

COMMENTARY - Section 226.2(a)(20)-4

*Finance charge on an outstanding balance.* The requirement that a finance charge may be computed and imposed from time to time on the outstanding balance means that there is no specific amount financed for the plan for which the finance charge, total of payments, and payment schedule can be calculated. A plan may meet the definition of open-end credit even though a finance charge is not normally imposed, provided the creditor has the right, under the plan, to impose a finance charge from time to time on the outstanding balance. For example, in some plans, such as certain “china club” plans, a finance charge is not imposed if the consumer pays all or a specified portion of the outstanding balance within a given time period. Such a plan could meet the finance-charge criterion, if the creditor has the right to impose a finance charge, even though the consumer actually pays no finance charge during the existence of the plan because the consumer takes advantage of the option to pay the balance (either in full or in installments) within the time necessary to avoid finance charges.

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- Finance charge for purposes of this criteria means the same as interest.
- Each subaccount has an interest rate disclosed as an ANNUAL PERCENTAGE RATE (when used with a number the words “ANNUAL PERCENTAGE RATE” must be more conspicuous than all other disclosures).
The Amount of Credit That May Be Extended is Generally Made Available to the Extent That Any Outstanding Balance is Repaid

COMMENTARY - Section 226.2(a)(20)-5

Reusable line. The total amount of credit that may be extended during the existence of an open-end plan is unlimited because available credit is generally replenished as earlier advances are repaid. A line of credit is self-replenishing even though the plan itself has a fixed expiration date as long as during the plan’s existence the consumer may use the line, repay, and reuse the credit. The creditor may verify credit information such as the consumer’s continued income and employment status or information for security purposes. This criterion of unlimited credit distinguishes open-end credit from a series of advances made pursuant to a closed-end credit loan commitment. For example:

Under a closed-end commitment, the creditor might agree to lend a total of $10,000 in a series of advances as needed by the consumer. When a consumer has borrowed the full $10,000, no more is advanced under that particular agreement, even if there has been repayment of a portion of the debt.

This criterion does not mean that the creditor must establish a specific credit limit for the line of credit or that the line of credit must always be replenished to its original amount. The creditor may reduce a credit limit or refuse to extend new credit in a particular case due to changes in the economy, the creditor’s financial condition, or the consumer’s creditworthiness. (The rules in section 226.5b(f), however, limit the ability of a creditor to suspend credit advances of home equity plans.) While consumers should have reasonable expectation of obtaining credit as long as they remain current and within any present credit limits, further extensions of credit need not be an absolute right in order for the plan to meet the self-replenishing criteria.

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- The plan as a whole is replenishing, not individual subaccounts.
- There may be a final date to borrow or for the plan to expire.
- Credit information about the member may be verified throughout the plan. The voucher and/or credit report are used for this purpose.
- A credit limit does NOT have to be established for either the plan or a particular subaccount. Some subaccounts such as overdraft protection or lines of credit often have a credit limit.
- The credit union may refuse an advance under the plan due to the member’s financial condition or creditworthiness. The credit union will want to have an updated picture of the member’s financial condition before making an advance.
2. **What Are the Advantages of Open-End Credit?**

- The Truth in Lending initial disclosures need to be given just once—at the time of plan opening.

- The Truth in Lending disclosures are much easier than closed-end credit and there are no calculations.

- The legal contract (Credit Agreement and Addendum) only has to be signed once—at the time of plan opening.

- Facilitates cross selling and preapproval.

- Facilitates remote access to credit.

- Credit union can underwrite each loan advance but not require the Member to complete an entire long application.

- Reduces paperwork for credit union.
3. **Why are Open-End Truth in Lending Disclosures so Easy to Make?**

- They do **not** have to be segregated from all other information in a “fed box” like closed-end credit. They can be included with the contract information as long as they are in an “integrated document.” The Credit Agreement and Addendum are an “integrated document” because they reference each other. The credit union should give the Credit Agreement and Addendum to the member **at the same time**.

- There are **NO** calculations so there is much less chance of making a mistake which would cause a truth in lending error and expose the credit union to substantial penalties.

- There are only 4 disclosures and many of them are preprinted in the Credit Agreement so the credit union doesn’t have to worry about making them.

Those disclosures and when they are found in the LOANLINER® form are:

a. **FINANCE CHARGE.** The circumstances under which a finance charge will be imposed and an explanation of how it will be determined.

   (1) When the finance charge begins to accrue and any grace period. (Credit Agreement)

   (2) Each periodic rate and corresponding annual percentage rate, and if applicable, variable rate disclosures. (Addendum)

   (3) Explanation of the method used to determine balance on which the finance charge may be computed. (Credit Agreement)

   (4) Explanation of how the amount of any finance charge will be determined, including description of how any finance charge other than the periodic rate will be determined. (Credit Agreement). However, if there is another component of the finance charge besides interest, it must be disclosed on the Addendum. Since it is a finance charge it must be more conspicuous than the other disclosures. In addition, the data processor must be able to disclose it correctly on the periodic statement. Most data processors are unable to do this disclosure correctly.

   Examples of such fees charged at the time of an advance are:

   - credit report fee
   - advance fee
   - processing fee

b. The amount of any charge other than a finance charge that may be imposed as part of the plan, or an explanation of how the charge will be determined. (Credit Agreement and/or Addendum). The specific fees are disclosed in the Addendum. Examples of what are considered “other charges” are found in the commentary to section 226.6. Collection costs are **not** a required disclosure. However because the member must agree to pay them they should be included on the Addendum as part of the legal contract.
c. The fact that the credit union has or will acquire a security interest in the property purchased under this plan or in other property identified by item or type. The generic language in the Credit Agreement always provides for a security interest in:

- shares and deposits
- collateral identified on Addendum
- cross collateral clause
  - property securing the plan secures all advances under the plan and any other amounts owed by the member to the credit union
  - dwellings never secure the plan
  - credit union does not have to enforce the cross collateral clause
  - are legal but a court may choose not to enforce it

The actual types of collateral are listed on the Addendum under subaccount description.

d. Statement of Billing Rights (Member’s copy of Credit Agreement)
4. **Who Signs What?**

- Borrowers must be members of the credit union.
- Persons who receive the proceeds of the advances and are obligated to repay are borrowers.
- Borrowers sign the Credit Agreement or the signature form.
- Since the Addendum is incorporated into the Credit Agreement by reference, the signatures to the Credit Agreement indicate agreement to the terms of the Addendum also. There is no legal requirement to sign the Addendum but Addendums with signature lines are available.
- The Credit Agreement is only signed once.
- A copy of the Credit Agreement and Addendum must be given to the borrower before the first transaction under the plan. If there are joint borrowers, only one of the borrowers needs to get a copy. Section 226.5(d).
- The Credit Insurance Application/Schedule should be signed by borrowers regardless of whether credit insurance is elected. Only borrowers are eligible for credit insurance coverage. That means guarantors cannot elect the credit insurance. The same rules apply to debt cancellation contracts.
- If collateral is taken as security for the advance, there must be agreement by the owners of collateral to the terms of the Security Agreement. The agreement can be obtained by:
  - signing the voucher
  - signing under the restrictive endorsement on the back of the proceeds check
  - if PLUS option is being used, signing the Permanent Security Agreement or Credit and Security Agreement.
- A guarantor signs a Guaranty Agreement, not the Credit Agreement. The guarantor can guarantee the entire plan, a subaccount or a particular advance. The guarantor should also receive a Notice to Co-Signer.
5. What are the Rules About Payments?

- As strange as it may sound the Truth in Lending Act and Regulation Z do NOT require that a payment be disclosed.

- For purposes of contract law, the member agrees to repay a certain amount. There are 2 ways to notify the member of the payment
  - on the Addendum – this works best if there is a set amount
  - on the Voucher at the time of each advance

- Payments are due monthly but the credit union can always change the frequency by agreement. This is most commonly done for payroll deduction.

- Payments are due on the last day of the month but the credit union has the right to change to another day.

- The member can always prepay without penalty. There are 2 types of prepayments. One kind is when the member wants to reduce the principal owing. The amount in excess of the regularly scheduled payment is all applied to principal. This is okay to do. The other, more common type, is when the member wants to "prepay" to allow them to skip subsequent payments for a period of time. This is okay if the credit union and member agree in writing on how this is to be handled. That written agreement can be on:
  - Addendum
  - Voucher
  - A separate agreement drafted by the credit union.

- Any type of payment is acceptable on an open-end plan including:
  - Amortized payments
  - Percentage of outstanding balance each month
  - Percentage of balance at time of advance
  - Fixed payment
  - Interest only
  - Balloon payment/single payment
6. Can You Charge an Application Fee on an Open-End Plan?

- An application fee can be charged at the time the plan is opened. It should not be charged at the time of each advance.

- The application fee is intended to cover the costs of processing the credit application. For example, it could cover the cost of a credit report.

- The application fee should not be refunded to members who are not approved for credit.

- The application fee does not have to be disclosed on any document.

- Credit unions should not charge an application fee at the time of each advance. A fee at the time of each advance (regardless of what it is called) is a transaction fee. It is also a finance charge. The effect of a finance charge has to be shown on the periodic statement which must be sent at least quarterly to members with an open-end plan. The effect of the finance charge is a higher APR. Most data processors cannot correctly calculate the APR on the periodic statement when any finance charge other than interest is imposed.

- The credit union may, and in most cases should, require the member to provide updated credit information at the time of a request for an advance. This does not mean obtaining a complete new application but rather giving the credit union information on changes in financial status and other information which is necessary to determine the member’s creditworthiness. This updated information can be obtained on:
  - Voucher
  - By a credit report
  - Any method/form the credit union chooses.

- The underwriting standards for the Consumer Legislation Endorsement to the CUMIS Bond permit a credit union to take a complete application every 24 months from members with existing plans. This can only be done if the credit union has established procedures in place to require the updated application. This time period assumes there will be major changes in a member’s financial status over a 2 year period and it may be easier to complete a new application rather than an update.
7. **Are There Certain Loans that Shouldn’t be Done on an Open-End Credit Plan?**

- Anytime a dwelling is given as security for an open-end credit plan, the plan becomes a “home equity plan” according to Regulation Z. The LOANLINER® open-end consumer credit plan was not designed to be a home equity plan and the home equity disclosures are not given in these documents.

Therefore the following types of subaccounts should not be part of the plan:

- mobile homes
- home equity
- real estate
- home purchase

- Home improvement subaccounts are okay as long as the property is not given as security.

- Credit cards are NOT part of the LOANLINER® agreement. They are not a subaccount. If the credit union offers credit cards, they need to provide a separate credit card agreement and disclosures. The LOANLINER® Credit Agreement cannot be used for credit cards.

Occasionally, you will see credit card tabular disclosures on Addendums. Since the tabular disclosures must be given at the time of application, the Addendum must be given with the application.

- Guaranteed government student loans should not be done on a LOANLINER® Plan.

- The LOANLINER® forms were not designed to be used for agricultural, business or commercial loans. These types of loans are not subject to the Truth in Lending Act. If the credit union wants to use the forms for one of these purposes, it should (1) realize that it is giving more disclosures than it needs to and (2) consult with its own legal counsel about whether these forms are legally adequate for doing this type of loan.

- The LOANLINER® forms were not designed to be used with living trusts. The credit union should consult with its local counsel on the advisability of using the forms with a living trust.

- Individual Retirement Account (IRA) secured advances should not be done as the borrower may lose the tax-exempt status if the IRA is given as security.
8. **How Should the Addendum Be Used?**

- The Addendum is part of the Credit Agreement. It is “incorporated by reference” to make it an integrated document.

- Since the Credit Agreement and Addendum are considered to be one document, the signature on the Credit Agreement is the only signature necessary.

- The Credit Agreement includes the language that is applicable to all credit unions. The Addendum includes the plan terms unique to each credit union’s plan.

- The Addendum is given out at the time the plan is opened, along with a copy of the Credit Agreement. That is the only time it needs to be given to the member.

- At the time the plan is opened, the member must receive an Addendum which discloses the current rates.

- The following terms should not be used:
  - **Unsecured** - The plan is always secured by the borrower’s shares and deposits so it is never considered "unsecured."
  - **Refinancing** - Loan advances on an open-end plan are not “refinanced.” Advances just continue to accrue interest at the applicable rate until repaid.
  - **Term** - This connotes a closed-end loan. The credit union may use "approximate term" to differentiate APR’s.

- A copy of the Addendum may, but does not have to be kept in each loan file. The credit union may maintain a master file of Addendums, in which a record is kept of which Addendum was used with plans opened during certain time periods, e.g., June 15 – August 31, 2002.

- Whenever a rate or fee changes, the Addendum must be updated.

- If the credit union wants to be able to impose collection costs, it must be included in the contract. Normally, collection costs are included on the Addendum.
9. How Should the Voucher be Completed?

- If the Voucher includes a security agreement and collateral is offered to secure an advance, the Security Agreement part of the Voucher is a legal document.

  In order to obtain a valid Security Agreement, the agreement must:

  ♦ be in writing
  ♦ identify the collateral
  ♦ be authenticated (signed)

  There is no requirement that all three of the criteria be on the same document. Therefore the signature can be on either the Voucher itself or under the restrictive endorsement on the back of the proceeds check.

- The owners of the collateral sign the Security Agreement.

- If no collateral is being offered as security, there is no requirement that the voucher be signed. The credit union may require the borrower(s)’ signatures but that is not mandatory and serves no legal purpose.

- The Voucher is used as a paper trail to notify the member of a new payment at the time of an advance.
10. **How Should the Disbursement Receipt be Used?**

- The Disbursement Receipt should only be used with the LOANLINER® PLUS.
- The Disbursement Receipt is used as a paper trail to notify the member of a new payment at the time of an advance.
- The Disbursement Receipt is used to identify the collateral given to secure an advance. The other requirements to create a valid Security Agreement are found in the Credit and Security Agreement.
- The Disbursement Receipt does not need to be signed.
- If there is an owner of collateral who is not a borrower (meaning that person did not sign Credit and Security Agreement), the owner must sign a Security Agreement.
11. **Can You Clearly Explain the Rules About Credit Cards?**

- The LOANLINER® application may be used to cross sell credit cards. A LOANLINER® application with a credit card option may be used to:
  - Provide a way to apply for a credit card. Remember that Reg. Z says a member must request a credit card, either orally or in writing.
  - If there is space, provide the application credit card disclosures that go with the application. These disclosures are either a tabular disclosure or a statement informing the consumer to contact the credit union to learn more about the costs of the credit cared. Sample disclosures for credit cards can be found in Appendix G of Regulation Z.
  - Agreeing to the terms of the Credit Agreement. The credit union must still provide copies of the credit card Credit Agreement. That is not part of the LOANLINER® Plan.
  - Agreeing to a consensual security interest in shares and deposits to secure the credit card.

- Reg. Z defines a credit card as “any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit.”

  This means that if an ATM card can be used to access the LOANLINER® Plan either directly or indirectly (overdrafting), the ATM card becomes a credit card.

  The LOANLINER® Plan includes all the necessary Truth in Lending disclosures that need to be made when an ATM card becomes a debit card. They include:
  - Request for the card
  - Lost card notification
  - Unauthorized use liability
  - Plan Merchant Dispute
  - Consensual Security Agreement in shares and deposits.

- The credit union must still provide a credit card agreement to the member since the LOANLINER® credit agreement is not a credit card agreement. The credit card agreement is usually sent by the card processor or credit union and may be sent with the card, as a separate mailing or as part of a custom lending solution brochure.
SERVICE & SUPPORT

One of the key features of the LOANLINER® lending system is service and support. You can have your questions answered by contacting any of the following:

- a CUNA Mutual Account Relationship Manager at:
  
  1-800-333-2644

- the LOANLINER® Systems Department at:

  Phone: 1-800-356-5012
  Fax: 1-608-233-4535
  E-Mail: loanliner@cunamutual.com

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