# DCU BULLETIN

**Division of Credit Unions**
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## Indirect Lending and Credit Tier Exceptions

The Division of Credit Unions (Division) is issuing this bulletin after reviewing underwriting practices for indirect lending at recent credit union examinations. This bulletin provides guidance for state-chartered credit unions on indirect lending underwriting procedures, credit risk concerns, and the importance of monitoring for potential fair lending violations if credit tier exceptions are permitted.

Background
A number of credit unions have indirect lending procedures and practices which allow underwriters to "bump" a vehicle loan applicant to a higher credit tier and interest rate that is more favorable to the applicant. This often occurs at the dealer's request, when the dealer provides a credit report from a credit reporting agency (CRA) that contains a slightly higher credit score than the score obtained by the credit union's CRA.

Credit risk concerns

Credit unions engaged in indirect lending must have clear underwriting practices that take into account objective factors such as borrower creditworthiness, the age and value of the collateral, and the terms of the transaction. The tiered pricing method allows creditors to set the material terms of credit by assigning each consumer to a discrete number of pricing tiers. While a tier "bump" provides the borrower a lower interest rate – sometimes up to 200 basis points – this also allows for a higher loan-to-value (LTV) ratio, and may result in a vehicle loan with negative equity.

Credit unions that permit tier rate exceptions or "bumps" must determine if this practice is in accordance with the board's lending policies and the credit union's risk and pricing models.

Credit unions should perform regular audits of indirect lending programs and pay close attention to trends in LTV, general loan exceptions, and concentrations of exceptions to any particular dealer.

Fair Lending risks

If tier bumps are requested and approved arbitrarily, certain applicants receive the benefit of preferential pricing while others do not. Procedures which allow dealers to initiate requests for tier bumps will significantly raise the risk of disparate impact under the Equal Credit Opportunity Act, as dealers have discretion to determine which applicants should be considered for a tier bump.

The Consumer Financial Protection Bureau (CFPB) has issued several bulletins and supervisory highlights on automobile finance and fair lending risks. A fair lending compliance management program is a critical tool for limiting fair lending risk in indirect auto lending. This includes:

- an up-to-date fair lending policy statement;
- regular fair lending training for all employees involved with any aspect of the institution's credit transactions, as well as all officers and Board members;
- ongoing monitoring for compliance with fair lending policies and procedures;
- ongoing monitoring for compliance with other policies and procedures that are intended to reduce fair lending risk (such as controls on dealer discretion);
- review of lending policies for potential fair lending violations, including potential disparate impact;
- depending on the size and complexity of the financial institution, regular analysis of loan data in all product areas for potential disparities on a prohibited basis in pricing, underwriting, or other aspects of the credit transaction;
- regular assessment of the marketing of loan products; and
- meaningful oversight of fair lending compliance by management and the financial institution's board of directors

See: CFPB Bulletin 2013-02 (March 21, 2013), *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf

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