I. PURPOSE

An indirect lending program allows members of the credit union to make a purchase and obtain financing at the same location. Examiners must evaluate the levels of risk in the indirect loan portfolio, determine if this level of risk is acceptable and determine whether management has sufficient controls in place to mitigate the risk. Examiners must ensure management complies with the requirements of state and federal regulations. Also, examiners must assess management's competency in understanding, monitoring, and underwriting indirect loans.

II. PRIMARY REFERENCES

1. Michigan Credit Union Act:
- **a.** Section 421: Credit Committee; powers; Loan Officers; etc.
- **b.** Section 422: Loan agreement with member or another domestic credit union
- **c.** Section 423: Loan conditions; repayment; costs; etc.

2. NCUA Rules and Regulations, Part 701.21(h): Third party servicing of indirect loans
3. NCUA Letter to Credit Unions 10-CU-15
4. Motor Vehicle Sales Finance Act

III. MINIMUM PROCEDURES

1. Review the Indirect Lending policy to ensure the policy includes appropriate:

a. Limitations

- **i.** Aggregate limits for both individual dealers and the total program. The maximum risk level for the program should be stated in terms of capital at risk and reflect the risk tolerance of the credit union. (example: total indirect loans will not exceed x% of net worth)
- **ii.** Limits per credit tier, as a percentage of the indirect loan portfolio.

b. Monitoring Controls

- **i.** Reporting requirement to monitor the performance of indirect loan activity generated from each dealership. Monitoring reports should include critical data for the

portfolio as a whole, as well as by dealer; critical data should include, at minimum: delinquency, current and cumulative losses, look-to-book ratios, and prepayments. Reviewing this information will aide in identifying problem dealers, as well as identify weaknesses within the program/portfolio.

ii. Profitability analysis requirement to review the actual rate of return/yield on the portfolio as a whole, as well as by dealership. The analysis should also be broken out by credit tier.

iii. Requirement to perform due diligence on dealerships, evaluating all key data included in monitoring reports, as well as overall performance of the dealership. Frequency at which due diligence reviews are required should be specified.

c. Credit Granting Criteria

i. Acceptable maximum loan-to-value ratios for collateral, including any allowed "add-ons," such as warranties, credit, disability, and GAP insurances.

ii. Requirements to independently verify collateral value, and evaluate the effect of any negative equity.

2. Review compliance with policy requirements, including indirect monitoring, dealer due diligence reviews, and profitability analysis.

3. Review a sample of recently granted indirect loans for the following:

a. Ensure the loan contract has been assigned to the credit union.

b. Determine whether the borrower's field of membership eligibility has been confirmed, and the loan was not funded prior to membership approval.

c. Ensure the general consumer loan policy criteria was followed for loan documentation, verification of income and employment, appropriate approval by authorized credit union personnel, and proper verification of lien placement.

IV. OTHER PROCEDURES TO PERFORM AS APPROPRIATE

1. Review written agreements with the dealers. Ensure the credit union has obtained a legal opinion regarding the contracts and agreements.
2. Verify indirect loans are being monitored by management and the board of directors by system generated reports. The indirect loans should be retrievable by type code for inclusion in reports based on the dealership of origin. Tracking of loan approvals, denials, charge-offs and delinquency can identify the quality of applications received from the dealerships.
3. Verify the credit union possesses the necessary license to purchase installment contracts, pursuant to the Motor Vehicle Sales Finance Act.
4. Review growth plans/projections for the Indirect Program. Evaluate risk management practices, and monitoring and due diligence procedures to ensure they are appropriate for managing anticipated/planned portfolio growth.