**March 2020**

**Skip Payment Programs**

Skip payment programs are seen as a win-win situation for both the credit union and the member. The credit union is able to earn more fee income and interest income while the member benefits with extra cash that month. With so many changes to Regulation Z during the past several years it is important to understand how those changes have impacted your credit unions ability to offer Skip Payment programs.

*Please Note: Michigan Credit Union League services are designed to provide accurate information with regard to the subject matter covered, with the understanding that the League does not render legal services. For specific legal advice, please consult with your credit union’s attorney.*

**Q.1. Does Regulation Z permit credit unions to offer skip payments to its members?**

**A.** Yes. Credit unions may offer skip payment programs to both their open-end and closed-end borrowers.

**Q.2. Does Regulation Z allow credit unions to charge a fee to any member that elects to skip a loan payment?**

**A.** Yes. Fees are permitted to be charged for both open- and closed-end loans. However, the rules for how skip payment fees are disclosed under open-end loans have changed since July 2010 (see “Open-End Loans” below).

**Q.3. Of what must we be aware when charging a skip a pay fee?**

**A.** For both open- and closed-end loans, the amount of the skip payment fee must be included in the calculation of the credit union’s APR for usury purposes as it is considered a finance charge under Regulation Z. The fee is considered a finance charge regardless of whether the fee is paid in cash, deducted from the members share or share draft account, or added to the loan balance. The usury limit for federally chartered credit unions is currently 18%. Michigan state chartered credit unions have no limit for credit cards and lines of credit loans, and a 25% limit on all other loans.

**Q.4. What about skip programs on loans secured by real estate?**

 **A.** Loans secured by real estate are challenging and can require significant contractual modifications. Skipped payments on real estate secured loans could also trigger a new flood insurance certifications and could create negative amortization issues. Credit unions should consult legal counsel before considering skip payment programs on real estate secured loans.

**Q.5. How many skipped payments a member can have in a year?**

 **A.** In some circumstances having several skipped payments could be viewed as a safety and soundness issue.  Though not addressed in regulation or statute, when there are more than 3 skips in a year an examiner could think a credit union is potentially concealing a TDR.  There are other issues that might come up depending on the type of loan as well.  For an auto loan a credit union might void the GAP policy if more than two skips are allowed. For open-end loans the interest rate could become inaccurate which would require recalculation of the APR if there are several skips within a certain timeframe.  What happens to the loan itself will determine how many skips a credit union would allow as well as what the examiners might think about the allowable number of skips.

There are skip programs covering consecutive months for teachers, seasonal workers, snowbirds, etc., but the computation would be included in the loan agreement and disclosures for these particular groups of members.

A credit union should keep in mind that if they are dealing with a disaster, such as hurricanes or pandemics, regulators may allow additional concessions to be made without examiner criticism. If additional skip payments would be considered in these circumstances a credit union should weigh the benefits and risks before allowing skips.

 **Open-End Loans**

 **Q.6. How has the fee disclosure for open-end loans changed since the amendments to Regulation Z became effective on July 2010?**

**A.** Prior to July 2010, Regulation Z required the skip payment fee to be incorporated into the Effective APR and disclosed on the corresponding periodic statement for open-end loans. Under the Reg. Z open-end loan changes that became effective on July 1, 2010, the requirement to calculate an Effective APR was eliminated. Credit unions must now include the skip payment fee in the list of transactions on the periodic statement and also itemize the skip payment fee in the fee boxes for the month and year-to-date.

**Q.7. Do we provide a change-in-terms notice for open-end loans?**

**A.** Credit unions must look their account opening disclosures to determine if a change-in-terms notice is required. If the features of the skip payment program are disclosed in the account opening disclosure, the credit union does not have to provide a change-in-terms notice. The account opening agreement would include the following information:

* Which month or months skip payments will be allowed (such as---"you may skip the December payment");
* The amount of any fee;
* How the credit union will collect that fee (for example, a withdrawal from the member’s share account);
* The fact that finance charges will continue to accrue on the account; and
* The payment amount upon resumption of regular payments.

If the skip payment features of an open-end loan are not provided in the initial account opening document, then a change-in-terms notice *would* *be* required before a member may skip a payment. Additionally, if no fee is charged, a change-in-terms notice would be required prior to resuming the original payment scheduled in order to notify members of the resumption of regular payments (even though no notice was required prior to the skipped payment).

 **Q.8. If a change-in-terms notice is required, what does Regulation Z require?**

**A.** A change-in-terms notice must be provided at least 45 days prior to resuming the regular payment schedule. Often this notice is combined with the initial letter or notice offering the skip payment. The notice informs the member of the resumption of the original payment either by explicitly stating when the regular payment resumes or by indicating the duration of the skip. For instance, the credit union can print on the August statement: “You may skip your October payment” and this can serve as the change-in- terms notice required prior to resumption of the regular payment schedule.

If a fee is charged, the credit union must provide a change-in-terms notice 45 days prior to the date the fee is charged. This notice could also be combined with the “resumption of payment notice” in a letter or notice offering the skip payment or it could be printed on a monthly statement as long as the notice is provided at least 45 days prior to the date the fee is charged.

**Closed-End Loans**

 **Q.9. Are new Regulation Z disclosures needed for closed-end loans for members who take advantage of the skip payment program?**

**A.** No. Regulation Z does not require new or subsequent disclosures for skip payments on closed-end loans. Generally, the only time new disclosures are required for closed-end loans is if a refinancing occurs (i.e., when an existing obligation is satisfied and replaced by a new obligation for the same borrower). New or subsequent disclosures are not necessary if the existing agreement is only being modified, for example, by lowering the payment or permitting a payment to be skipped.

Although the fee for allowing a skipped payment is considered a finance charge, new disclosures are not required as long as the skipped payment is accomplished by amending the existing closed-end loan agreement rather than by a complete refinancing. Because new disclosures are not required, the inaccuracy created by imposition of the fee is not a Truth-in-Lending violation according to Section 226.17 (e) of Regulation Z.

**Q.10. What should be included in our skip a payment notice to our members?**

**A.** The credit union should make members aware of a number of issues including: which loans and borrowers are eligible for skip a payment, which month(s) a skip payment will be allowed, the amount of any fee, how the credit union will collect that fee and the effect the skip payment will have on increasing the total finance charges and extending the loan term.

**Q.11. How can we provide the skip payment program offering to our members for closed-end loans?**

 **A.** A promotional piece advertising the skip payment offering may be sent as a letter with a tear-off along the bottom for the member to sign and return to the credit union which acknowledges the member’s desire to skip a particular loan payment and indicates that the member understands and agrees to the skip payment terms and conditions.