THE OFFICE OF SMALL CREDIT UNION INITIATIVES
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**Risk-Based Lending Pricing Policy and Practice**

To properly maintain credit union loan policies and assure their agreement with actual practices, a staff member should be assigned as the policies compliance officer. The compliance officer's duties should be supervised by the supervisory committee or the board of directors.

The loan policy should be reviewed at least annually, and adjusted and revised as necessary. The purpose of the loan policy is to provide guidance on the proper procedures for acceptance and review of loan applications, and the funding limits and types of acceptable loans. The policy guides the office staff, loan officers and credit committee in processing loan applications.

If a credit union uses risk-based loan pricing, the compliance officer will need to perform additional duties to advise the Credit Committee on recommended revisions. The compliance officer will need to be knowledgeable of FICO scoring if it is the basis for the credit union's underwriting. Credit scores are often called FICO scores because most scores in the U.S. are based on software developed by the Fair Isaac and Company.

FICO scores can be used as an indicator of future credit risk based on an applicant's credit report - the higher the score, the lower the risk. However, the score alone does not indicate whether a borrower will be "good" or "bad." Generally, a FICO score of 620 or lower is considered subprime. A credit union should use a combination of the FICO score and score adjustments, based on factors management determines that indicate a higher probability of debt repayment to yield a "paper grade" for applicants.

NCUA's Letter to Credit Union, 99-CU-05, "Risk-Based Lending," identifies the following minimum elements for a risk-based loan policy:

- Types of products offered and those that are not authorized;
- Portfolio targets and limits for each credit (paper) grade or class;
- Clearly stated lending authority;
- Standards for collateral evaluations and appraisals;
- Well-defined and specific underwriting parameters;
- Procedures for tracking and monitoring of loan exceptions; and
- Standards for credit file documentation.

Credit union management might be surprised to learn some of the variables can adversely affect a credit score. Some examples include:

- Avoiding credit. A high credit score comes, in part, from using credit, so the lack of a credit history results in a lower score.
- Closing unused credit cards. Such action results in an increased ratio of outstanding debt

to available credit.

- Accepting unneeded credit. Such action increases the number of credit inquiries, which increases the score.
- Consolidating debt to a low-interest card.  This results in a higher level of debt outstanding on the credit line.
- Errors on credit report. This could be due to information from another individual or individuals.
- New utility account. This is another cause of credit inquiries.

A credit union should base its risk-based loan pricing on the paper grade determined through its underwriting process.  A regular and robust review of loan policies and practices will help ensure creditworthy members are welcomed and well-served by your credit union.

**For questions about reviewing your credit union's loan policy and pricing, contact our consultants by email at oscuiConsulting@ncua.gov.**