March 12, 2004

Mr. C. Kevin Kolar
Bradford Scott Data Corporation
9365 Counselor's Row, Suite 210
Indianapolis, IN 46240

Re: Tracking Late Fees.

Dear Mr. Kolar:

You have asked if a federal credit union's (FCU) data processing software may track the collection of a late fee assessed against a borrower by posting the amount to a "partial payment" account. As discussed below, we believe this treatment does not violate NCUA's credit practices rule.

NCUA's credit practices rule addresses the circumstance in which a borrower has incurred a late fee that remains unpaid. 12 C.F.R. § 706.4. Where the member's next regular payment is made on time and in the scheduled amount, the rule prohibits an FCU from assessing another late fee simply because the amount of the subsequent loan payment does not include payment of the late fee assessed in the earlier period. 12 C.F.R. § 706.4(a). The rule is designed to prohibit the "pyramiding" of late fees.

We understand that your firm provides data processing services for FCUs. Your letter describes several scenarios involving the treatment of late fees. You first discuss the circumstance in which a debtor makes a regular payment late and incurs a late fee. In the period in which the fee is assessed, an amount equal to the fee, which would have otherwise been credited to principal, is taken from the regular periodic payment and applied to the late fee. Because of the application of the late fee, the term of the loan will be extended beyond its regularly scheduled maturity, since principal will be short by an amount equal to the late fee. Because the debtor paid the regular monthly payment amount, however, the due date is advanced to the next regularly scheduled payment date.

This illustration complies with the rule, since the tender of the regularly scheduled payment is sufficient to advance the due date, even though the late fee is assessed. Thus, the next scheduled payment will be due in the regular amount, and payment of that amount will not be considered insufficient or delinquent even though it does not include an additional amount equal to the late fee assessed in the earlier period.

Your letter also discusses the circumstance in which the borrower includes an additional amount, equal to the late fee assessed, with his regular periodic payment. You have asked about the appropriate data processing treatment for this additional amount, since it reflects an excess over the regularly scheduled payment of principal and interest. Your software handles the additional amount representing the late fee as though it were a partial payment, in other words, a payment in advance against the next regularly scheduled payment. We believe this treatment is permissible, even though it will not be shown on the member statement as an actual prepayment. Instead, as we understand, this approach is simply a way for the data processing system to account for and accept the payment.

Your letter goes on to describe a circumstance that is not in compliance with our rule. In this case, the FCU assesses a late fee against the amount tendered by the borrower but characterizes the payment as short because the borrower has only made the regular monthly payment, which is not enough to cover both principal and interest and the late fee. Thus, the due date is not advanced and the loan is considered

delinquent. The next regularly scheduled payment is made, on time, but the FCU assesses another late fee because of the previously declared delinquency. In this example, the borrower's subsequent payments, made on time and in the prescribed amount, are not properly treated because of a preexisting delinquency. This is the type of treatment that is prohibited by our rule. 12 C.F.R. § 706.4(a).

Sincerely,

Sheila A. Albin
Associate General Counsel

OGC/RPK:bhs
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