



DCU BULLETIN

Division of Credit Unions

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Guidance on Home Equity Lines of Credit

The Director of Credit Unions advises credit unions to review the Guidance on Home Equity Lines of Credit (HELOCs) issued on August 26, 2008 by the Office of Thrift Supervision (OTS). Credit unions have similar safety/soundness and compliance issues as savings associations. Attached is a copy of the guidance. You can also view it at <http://files.ots.treas.gov/481121.pdf>.

OTS's cover letter to the guidance states the following:

Declining home prices in parts of the country are prompting some institutions to curtail, suspend, or terminate customers' home equity line of credit. Today's guidance emphasizes that institutions taking such actions must comply with federal laws and rules designed to protect customers, including regulations implementing the Truth in Lending Act, Equal Credit Opportunity Act, Fair Housing Act and the OTS nondiscrimination rule.

"A home equity line of credit is an attractive product for many homeowners and lenders," the guidance said. "While sound underwriting and effective risk management systems are essential, associations must employ these strategies in a manner that complies with applicable consumer protection laws and regulations."

While Division of Credit Unions has not received consumer complaints about credit unions restructuring HELOCs, Linda Jekel, Director of Credit Unions, finds the OTS guidance as good direction for credit unions and examiners. For credit unions, also see NCUA Letter 05-CU-07 "Managing Risks Associated with Home Equity Lending" published in May 2005. Credit unions should obtain legal advice regarding nondiscrimination practices, including what is prohibited in advertising (see 12 C.F.R. Part 741.211 and Part 740.2).

Please contact Linda Jekel, Director of Credit Unions at (360) 902-8778 or LJekel@dfi.wa.gov, if you have any questions.

OTS 08 038 - OTS Issues Guidance on Home Equity Lines of Credit

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HOME EQUITY LINE OF CREDIT ACCOUNT MANAGEMENT GUIDANCE

A home equity line of credit (HELOC) is a form of revolving credit in which the borrower's home serves as collateral. With a HELOC, an applicant will be approved for a specific amount of credit that can be borrowed.¹ Since HELOCs often have long-term or interest-only payment features, OTS expects associations to actively manage their home equity portfolios. To do so, associations should:

- Maintain effective risk management systems, as explained in the 2005 Credit Risk Management Guidance for Home Equity Lending² (2005 HELOC Guidance), and
- Comply with the OTS real estate lending standards rules³ and related guidance.

The goal of managing credit risk is important from a safety and soundness perspective. Therefore, associations often structure HELOC plans so that the available credit limit can be reduced, suspended, or terminated. When taking such actions, associations must follow the federal laws and rules designed to protect HELOC customers. OTS will review associations' HELOC account management policies and practices to ensure compliance with these requirements, which are explained below.

TERMINATING, REDUCING, OR SUSPENDING A HELOC: LEGAL RISKS

Truth in Lending Act (TILA) / Regulation Z

Regulation Z, which implements TILA, sets forth the circumstances under which a HELOC⁴ can be terminated, suspended, or reduced.⁵ Savings associations are responsible under Regulation Z for timely reinstatement of lines of credit which cease to meet the criteria for suspension or reduction. These requirements are discussed in the following sections.

Termination of Line / Demand of Full Repayment

With limited exceptions, Regulation Z prohibits creditors from terminating a HELOC and accelerating repayment of the outstanding balance before the scheduled expiration of the plan.⁶

¹ For more information about HELOC's, see *The Federal Reserve Board, "What You Should Know About Home Equity Lines of Credit,"* June 12, 2007, available at http://www.federalreserve.gov/Pubs/equity/equity_english.htm.

² See "Credit Risk Management Guidance for Home Equity Lending" May 16, 2005, available at <http://www.ots.treas.gov/docs/2/25222.pdf>. The agencies provided additional guidance for managing risks associated with HELOCs that contain interest-only features in 2006. See Addendum to 2005 HELOC Guidance, September 29, 2006, available at <http://www.ots.treas.gov/docs/4/480269.pdf>.

³ 12 C.F.R. § 560.101

⁴ The relevant provisions of Regulation Z apply to all open-end credit plans secured by the consumer's dwelling, not just those secured by a consumer's principal dwelling. 12 C.F.R. pt. 226, Supp. I, commentary to section 226.5b, comment 1.

⁵ When a borrower applies for a HELOC, Regulation Z requires a lender to disclose the possibility that it may take such action later. 12 C.F.R. § 226.5b(d)(4)(i). When such action is actually taken, Regulation Z also requires that the borrower be given notice. 12 C.F.R. § 226.9(c)(3).

HELOC agreements must conform to these restrictions and may not contain provisions that authorize termination unless an exception applies.⁷

Exceptions include situations that involve the following action/inaction by the borrower:⁸

- Fraud or material misrepresentation;
- Failure to meet repayment terms for any outstanding balance; or
- Actions adversely affecting the property pledged as security or the creditor's security interest in the property.

If an event permitting termination and acceleration occurs, OTS encourages associations to work with borrowers to determine an appropriate strategy for mitigating risk. For example, an association could suspend or "freeze" further advances, reduce the credit limit, or change payment terms.

Suspension or Reduction of Line

With some exceptions, Regulation Z prohibits a creditor from changing any term of a HELOC account.⁹ Notably, however, a creditor may prohibit additional extensions of credit or reduce the credit limit during certain periods,¹⁰ as long as any reduction in a borrower's credit limit below the outstanding balance does not require the borrower to make a higher payment.¹¹ Consistent with Regulation Z, creditors may freeze or reduce a HELOC account when:¹²

- ***The value of the collateral declines significantly below the appraised value.***
Although a "significant decline" will vary according to individual circumstances, Regulation Z has been interpreted to mean that such decline in value has occurred when the difference between the credit limit and available equity at the time that the HELOC account was granted has been reduced by fifty percent from the difference between these values at the time that the HELOC account was granted.¹³ An association's action to suspend or reduce a HELOC must be based on an assessment of the value of "the dwelling that secures the plan."¹⁴ Consequently, an association would violate Regulation Z if it attempted to suspend or reduce the credit limits of all HELOC accounts in a geographic area in which real estate values are generally declining without assessing the value of the collateral that secures each affected

⁶ 12 C.F.R. § 226.5b(f)(2).

⁷ 12 C.F.R. pt. 226, Supp. I, commentary to paragraph 226.5b(f)(2), comment 1.

⁸ 12 C.F.R. § 226.5b(f)(2).

⁹ 12 C.F.R. § 226.5b(f)(3).

¹⁰ 12 C.F.R. § 226.5b(f)(3)(vi).

¹¹ 12 C.F.R. pt. 226, Supp. I, commentary to paragraph 226.5b(f)(3)(vi), comment 1.

¹² 12 C.F.R. § 226.5b(f)(3)(vi).

¹³ 12 C.F.R. pt. 226, Supp. I, commentary to paragraph 226.5b(f)(3)(vi), comment 6 provides the following example: Assume that a house with a first mortgage of \$50,000 is appraised at \$100,000 and a \$30,000 HELOC account is opened. The difference between the HELOC limit and available equity is \$20,000, half of which is \$10,000. The creditor could prohibit further advances or reduce the credit limit if the value of the property declines from \$100,000 to \$90,000.

¹⁴ 12 C.F.R. § 226.5b(f)(3)(vi)(A)

HELOC account.¹⁵ While Regulation Z does not require a savings association to obtain an appraisal to determine whether collateral value has significantly declined,¹⁶ an association should have a sound factual basis for reaching this conclusion. OTS expectations for prudent collateral monitoring practices are addressed in the 2005 HELOC Guidance noted above.

- ***The creditor reasonably believes that the consumer will be unable to make payments as agreed because of a material change in the consumer's financial circumstances.***

It is important to recognize that this exception requires both a material change in a borrower's financial situation and the creditor's reasonable belief that the borrower will not be able to repay the HELOC account as agreed.¹⁷

- ***The consumer is in default on a material obligation of the HELOC agreement .***

An association may specify events that would qualify as a default in a HELOC account.¹⁸ For example, an association may provide that default on a material obligation will exist if the consumer moves out of the dwelling or permits an intervening lien to be filed that would take priority over future advances made by the association.¹⁹

Reinstatement of Credit Privileges

Regulation Z permits an association to suspend or reduce a HELOC account only when the designated circumstances exist, and the regulatory commentary emphasizes that credit privileges must be timely reinstated when those circumstances cease.²⁰ One way that an association can meet this responsibility is by monitoring an affected line of credit frequently enough to assure itself that the condition permitting the suspension or reduction continues to exist.²¹ Alternatively, an association may require borrowers to request reinstatement of credit privileges.²² When a consumer requests such reinstatement, the association must promptly determine whether the condition allowing the suspension remains in effect.²³ In doing so, an association may charge the consumer bona fide, reasonable fees for services actually used to make this determination.²⁴ An association may not impose a fee to reinstate a credit line once the condition has been determined not to exist.²⁵

¹⁵ For example, the data provided in the Office of Federal Housing Enterprise Oversight House Pricing Index, see <http://www.ofheo.gov/HPI.aspx>, could not be used as the sole basis for a decision to reduce or freeze the credit limits of all borrowers in a specific geography.

¹⁶ 12 C.F.R. pt. 226, Supp. I, commentary to paragraph 226.5b(f)(3)(vi), comment 6.

¹⁷ Id. at comment 7.

¹⁸ Id. at comment 8.

¹⁹ Id.

²⁰ Id. at comment 2.

²¹ Id. at comment 4.

²² Id. If the association requires the consumer to request reinstatement of credit privileges, it must notify the consumer of that fact under 12 C.F.R. § 226.9(c)(3).

²³ 12 C.F.R. pt. 226, Supp. I, commentary to paragraph 226.5b(f)(3)(vi), comment 4.

²⁴ Id. at comment 3.

²⁵ Id.

Fair Lending: Substantive Concerns about Reducing the Availability of Credit

The Equal Credit Opportunity Act (ECOA) and its implementing Regulation B, the Fair Housing Act and its implementing regulation, and the OTS Nondiscrimination rule all prohibit associations from discriminating based on race, sex/gender, or other protected characteristics when making credit decisions.²⁶ Notably, associations that suspend or reduce HELOCs based on declining property values should take responsible steps to avoid the possibility of redlining.²⁷ Moreover, to help ensure that actions to terminate, reduce, or suspend HELOCs are carried out in a non-discriminatory manner, associations should follow policies that are based on prudent risk management principles and carry them out without regard to prohibited factors.²⁸

Adverse Action Notices

Requirements under Regulation B

When an action is determined to be “adverse” under Regulation B, a creditor is responsible for providing a borrower with a timely adverse action notice that contains specific information about the reasons for the action taken.²⁹ The termination, suspension, or reduction of a HELOC account is not treated as an adverse action under Regulation B if an applicant has expressly agreed to a change in terms³⁰ or when an action is taken due to the “inactivity, default, or delinquency” of the account.³¹ Applying these rules together with the provisions of Regulation Z discussed above, the termination, suspension, or reduction of an individual HELOC permitted by Regulation Z would not constitute an adverse action in a number of contexts. For example, these actions would not be viewed as “adverse” under Regulation B where an applicant has signed a HELOC agreement that permits an association to suspend or reduce a HELOC when the value of the collateral securing the HELOC has significantly declined below the appraised value or where a material change in a borrower’s financial situation has occurred.

²⁶ See 15 U.S.C. § 1501 *et seq.*; 12 C.F.R. pt. 202; 42 U.S.C. § 3601 *et seq.*; 24 C.F.R. pt. 100 *et seq.*; and 12 C.F.R. pt. 528.

²⁷ Redlining is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. OTS’s Examination Handbook, section 1201.5 (March 2007) and Interagency Fair Lending Examination Procedures, page iv, available at <http://www.ffiec.gov/pdf/fairlend.pdf>.

²⁸ See 12 C.F.R. §§ 528.2a (OTS Nondiscriminatory appraisal and underwriting rule) and 528.9 (OTS Guidelines relating to nondiscrimination in lending). See also 12 C.F.R. § 560.101 (real estate lending standards).

²⁹ For more information about adverse action notice requirements, see 12 C.F.R. § 202.9.

³⁰ 12 C.F.R. § 202.2(c)(2)(i).

³¹ 12 C.F.R. § 202.2(c)(2)(ii).

Requirements Under the Fair Credit Reporting Act (FCRA)

A savings association must also provide an adverse action notice under FCRA if it takes adverse action³² based on information contained in a consumer report from a consumer reporting agency or on information obtained from others that bears on credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living.³³ For example, if an association relies on information in a consumer report to conclude that a consumer's financial circumstances have changed so materially that the consumer will be unable to fulfill HELOC repayment obligations, the association must provide a FCRA adverse action notice if it suspends or reduces the HELOC account.

Unfair or Deceptive Acts or Practices

As discussed above, there are circumstances in which an association is permitted to terminate, suspend, or reduce a HELOC. Nevertheless, Section 5 of the Federal Trade Commission Act (FTC Act) prohibits associations from taking such actions in an unfair or deceptive manner.³⁴ A practice is "unfair" when it causes or is likely to cause substantial injury that consumers cannot avoid and which is not outweighed by countervailing benefits to consumers or to competition.³⁵ A practice is "deceptive" when it involves a material representation or omission that is likely to mislead a reasonable consumer. ³⁶ Notably, the FTC Act prohibition against unfair or deceptive practices applies to all aspects of a loan transaction, including servicing and collection.³⁷

In addition, OTS has long prohibited inaccurate representations or advertising,³⁸ including both material misstatements and omissions.³⁹ Statements that are technically accurate, but misleading, are included in this prohibition.⁴⁰ Consequently, associations should avoid promoting HELOC accounts as a means to easily obtain credit without also indicating that access to such credit can be frozen, reduced, or terminated.

CONCLUSION

A HELOC is an attractive product for many homeowners and lenders. While sound underwriting and effective risk management systems are essential, associations must employ these strategies in a manner that complies with applicable consumer protection laws and regulations. To effectively address both credit and legal risk, associations must appropriately integrate safety and soundness and compliance measures. Questions about how to strike this balance should be directed to OTS regional offices.

³² The definition of "adverse action" is the same under FCRA and ECOA. See 15 U.S.C. § 1681a(k).

³³ 15 U.S.C. § 1681m

³⁴ 15 U.S.C. § 45.

³⁵ See 73 Fed. Reg. 28904, 28907-08 (May 19, 2008)

³⁶ See 73 Fed. Reg. at 28908-09.

³⁷ See, e.g., United States v. Fairbanks Capital Corp., No. 03-12219 (D. Mass. 2003) and FTC v. Capital City Mortgage Corp., No. 98-00237 (D.D.C. 1998).

³⁸ 12 C.F.R. § 563.27.

³⁹ FHLBB Memorandum R-51a (September 9, 1981), available at 1981 FHLBB LEXIS 33.

⁴⁰ FHLBB Inter-Office Communication (January 18, 1977), available at 1977 LEXIS 219.

For further information about the specifics of this [OTS] guidance, please contact:

- April Breslaw (202-906-6989) (compliance/consumer protection issues); or
- Debbie Merkle (202-906-5688) (safety and soundness issues)