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To the Point!

legal, operations, and strategy briefs for financial institutions July 15, 2014

Interagency Guidance on Home Equity Lines of Credit Nearing Their End-of-Draw Periods

On July 1, 2014, the federal banking regulatory agencies and the Conference of State Bank Supervisors issued the *Interagency Guidance on Home Equity Lines of Credit Nearing Their End-of-Draw Periods* (the "*Guidance*"). The Guidance recognizes that borrowers who received HELOCs during the housing boom may face payment shock as their draw periods end and may not be able to pay as expected or refinance due to economic conditions and property values that have changed since their loans were originated. The Guidance states that lenders must manage these risks in a disciplined and prudent manner, working with borrowers to avoid unnecessary defaults.

The Guidance refers lenders to six earlier publications that include supervisory expectations related to HELOC underwriting, account management, accounting and reporting, and loss mitigation activities. The Guidance also identifies ten risk management expectations and five core operating principles that should govern lenders' oversight of HELOCs reaching the end-of-draw period.

The regulators encourage lenders to be proactive and "consider the impact of payment shock and loss of line availability associated with the end-of-draw period" by identifying vulnerable borrowers. The Guidance provides that lenders should contact borrowers six to nine months before their HELOC draw periods end, noting that several attempts to contact borrowers may be required to achieve the best timing and messaging.

As to loan modifications, the Guidance states that the modification terms must be sustainable and that restructuring to balloon loans or interest-only payments will generally be inappropriate for vulnerable borrowers since such structures do not address repayment issues.

Finally, the Guidance cautions lenders that they must comply with applicable consumer protection laws in working with borrowers nearing the end-of-draw period.

Financial institutions should review the Guidance and their end-of-draw period policies and practices to ensure that they address the concerns raised by the regulators, including minimizing risk to the institution.

Mortgage Rules Update: Application of the Ability to Pay Rule

The CFPB issued an interpretive rule on July 8, 2014 that exempts lenders from compliance with the Ability to Pay requirements (*"ATR Rule"*) when an individual requests to be added to a mortgage loan following the individual's acquisition of an interest in the property, such as through inheritance or divorce. In such circumstances the lender can add the successor to the mortgage, and modify the terms of the mortgage, without triggering the application of the ATR Rule.

In order to come to this conclusion, the CFPB was required to distinguish between circumstances that are an assumption under Regulation Z (which triggers application of the ATR

Rule) and those circumstances that are not an assumption. An assumption under Regulation Z includes the following: (a) a written agreement; (b) an express acceptance of the subsequent borrower by the lender; and (c) a residential mortgage transaction. In the case of inheritance or divorce, the acquisition of the successor's interest occurs before the successor becomes obligated on the mortgage; thus, the transaction is not a residential mortgage transaction.

The CFPB notes further that although the transaction is not an assumption, it is a consumer credit transaction subject to Regulation Z requirements including periodic statements and notices regarding interest rate adjustments.

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