Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
National Credit Union Administration
Conference of State Bank Supervisors

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

The federal financial institutions regulatory agencies (the agencies)[1] in conjunction with the Conference of State Bank Supervisors recognize that financial institutions and residential mortgage borrowers may face challenges as home equity lines of credit (HELOC) near their end-of-draw periods. As HELOCs transition from their draw periods to full repayment, many borrowers will have the financial capacity to pay as agreed. Some borrowers, however, may have difficulty meeting higher payments resulting from principal amortization or interest rate reset, or renewing existing loans due to changes in their financial circumstances or declines in property values.

When borrowers experience financial difficulties, financial institutions and borrowers generally find it beneficial to work together to avoid unnecessary defaults. As HELOC draw periods approach expiration, lenders should communicate clearly and effectively with borrowers and prudently manage exposures in a disciplined manner.

This guidance describes core operating principles that should govern management's oversight of HELOCs nearing their end-of-draw periods. The guidance also describes components of a risk management approach that promotes an understanding of potential exposures and consistent, effective responses to HELOC borrowers who may be unable to meet contractual obligations. In addition, the guidance highlights concepts related to financial reporting for HELOCs. The HELOC end-of-draw guidance should be applied in a manner commensurate with the size and risk characteristics of a financial institution's HELOC portfolio.

Background

A HELOC is a dwelling-secured line of credit that generally provides a draw period followed by a repayment period. During the draw period, a borrower has revolving access to unused amounts under a specified line of credit. This line of credit often requires interest-only payments. During the repayment period, borrowers can no longer draw on the line of credit, and the outstanding principal is either due immediately in a balloon payment or is repaid over the remaining loan term through higher monthly payments, resulting in payment shock.

General supervisory expectations for appropriate HELOC underwriting, account management, accounting and reporting, and loss mitigation activities are addressed in publications that cover the following topics:

- *Credit Risk Management Guidance for Home Equity Lending*[2]
- *Uniform Retail Credit Classification and Account Management Policy*[3]
- *Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructurings*[4]
- *Interagency Supervisory Guidance on Allowance for Loan and Lease Losses Estimation Practices for Loans and Lines of Credit Secured by Junior Liens on 1-4 Family Residential Properties* (Interagency Junior Lien Allowance Guidance)[5]
- Glossary entries for *Loan Impairment* and *Troubled Debt Restructurings (TDR)* in the Instructions for the Consolidated Reports of Condition and Income (Call Reports)[6]
- *Real Estate Lending Standards Regulations* and the *Interagency Guidelines for Real Estate Lending Policies*[7]

End-of-Draw Risk Management Principles

As part of the supervisory process, examiners will review financial institutions' end-of-draw risk management programs for provisions that address five risk management principles:

1. **Prudent underwriting for renewals, extensions, and rewrites.[8]** Management should apply prudent underwriting and loss mitigation strategies whenever existing loan terms for borrowers nearing the end of their contractual period are modified. Prior to extending draw periods, modifying notes, and establishing amortization terms for existing balances, lenders should conduct a thorough evaluation of the borrower's willingness and ability to repay the loan.
2. **Compliance with pertinent existing guidance, including but not limited to the *Credit Risk Management Guidance for Home Equity Lending* and the *Interagency Guidelines for Real Estate Lending Policies*.** Management's criteria for HELOC underwriting and credit analysis should be consistent with regulatory guidance for prudent real estate lending. A financial institution's underwriting criteria should include debt service capacity standards, creditworthiness standards, equity and collateral requirements, maximum loan amounts, maturities, and amortization terms. Management also should establish review and approval procedures for policy exceptions and require ongoing timely and accurate portfolio reporting, including performance and composition reports.
3. **Use of well-structured and sustainable modification terms.** For those borrowers who may be experiencing financial difficulties, management should participate in or establish workout and modification programs where feasible.[9] Terms of such programs should be consistent with the nature of the borrower's hardship, have sustainable payment requirements, and promote orderly, systematic repayment of amounts owed. Restructuring to an interest-only or balloon loan is generally inappropriate for higher-risk borrowers, as these types of loans do not directly address repayment issues. Where modifications are out of compliance with a financial institution's current underwriting criteria, for example, when combined loan-to-value ratios (CLTV) exceed a financial institution's established guidelines, payment

arrangements should bring exposures into compliance in a structured and orderly manner while keeping payments sustainable.

4. **Appropriate accounting, reporting, and disclosure of troubled debt restructurings.** Management should review end-of-draw modifications for appropriate identification of TDRs and accrual status. TDR treatment is appropriate when a lender grants a concession to a borrower that it would not otherwise consider because of the borrower's financial difficulties.[10] Financial difficulties can include the probable inability of a borrower to meet the loan terms, assuming no modification takes place when the borrower is facing a scheduled balloon payment at maturity or the payment shock associated with a contractual increase in the monthly payments.

5. **Appropriate segmentation and analysis of end-of-draw exposure in allowance for loan and lease losses (ALLL) estimation processes.** Estimates of the ALLL, including TDR impairment estimates, should consider the impact of payment shock and loss of line availability associated with the end-of-draw period. In accordance with the "Interagency Junior Lien Allowance Guidance," HELOCs approaching their end-of-draw periods should, when volumes warrant, generally be a separate portfolio segment in the ALLL estimation process. Before significant HELOC volumes reach their end-of-draw periods, management should be capturing information and preparing analyses that clarify the nature and magnitude of exposures.

End-of-Draw Risk Management Expectations

Management should implement policies and procedures for managing HELOCs nearing their end-of-draw periods that are commensurate with the size and complexity of the portfolio. Prudent risk management expectations generally include:

1. **Developing a clear picture of scheduled end-of-draw period exposures.** Management reports should provide a clear understanding of end-of-draw exposures and identify higher-risk segments of the portfolio. Management reports should also identify contractual draw period transition dates for all HELOCs, showing maturity schedules in the aggregate and by significant segments of performing and non-performing borrowers (including distinguishing between performing borrowers that are higher risk and those that are not). Segments typically include product types, post-draw payment characteristics (such as interest-only payments, balloon payments, and amortization periods), origination channels (such as retail, broker, correspondent, and mergers), or borrower characteristics (such as credit score bands and utilization rates) where performance may vary. Refer to the Interagency Junior Lien Allowance Guidance for further information on account and portfolio management.

   Additional analyses that include expected payoffs, attrition, utilization rates, delinquency or modification status of associated first liens,[11] or other factors that might change risk levels before contractual end-of-draw periods may also be helpful to assess risk. For example, pre-end-of-draw payment history for a borrower may indicate that contractual payment shock will have a limited effect on that borrower if the payments made have consistently exceeded the minimum amount due.

2. **Ensuring a full understanding of end-of-draw contract provisions.** Transition issues such as payment changes, interest rate options, amortization terms, lockout[12] and debt consolidation options, and payment processing should be controlled and programmed correctly into servicing systems. This task can be challenging when existing portfolios are the result of numerous mergers, acquisitions, or origination channels over the years. This exercise often includes a detailed inventory of contracts and contract provisions to ensure management understands all parties' rights and obligations. Institutions should monitor options available to lenders and borrowers such as draw period extensions or interest rate locks, and institutions should be aware of the timing of any required notifications to borrowers.

3. **Evaluating near-term risks.** Some HELOCs approaching their end of their draw periods may already have line availability suspended due to collateral value declines or borrower repayment performance problems. These accounts warrant attention and may require workout arrangements or modifications if not already addressed. Management should also evaluate borrowers making only the contractual minimum interest-only payments to consider whether those borrowers will meet current underwriting standards or qualify for renewal or rewrite programs.

4. **Contacting borrowers through outreach programs.** Management should begin reaching out to borrowers well before their scheduled end-of-draw dates to establish contact, engage in periodic follow-up with borrowers, and respond effectively to issues. Lenders often find that successful outreach efforts start at least six to nine months or more before end-of-draw dates, with simple, direct messaging. Many successful programs have required several attempts to contact borrowers to achieve the most effective timing and messaging.

5. **Ensuring that refinancing, renewal, workout, and modification programs are consistent with regulatory guidance and expectations, including consumer protection laws and regulations.** Financial institutions are encouraged to work prudently with higher-risk borrowers to avoid unnecessary defaults. Well-designed and consistently applied workout and modification programs can minimize losses and help borrowers resume structured, orderly repayment. Such programs should include payment terms that, in conjunction with of all of the borrower's other obligations, are sustainable and promote the orderly and systematic repayment of principal. Management should structure end-of-draw period renewal, workout, and modification programs to:

   - base eligibility and payment terms on a thorough analysis of a borrower's financial condition and reasonable ability to repay.
   - provide payment terms that are sustainable and avoid unnecessary payment shock.
   - avoid modifications that do not amortize principal in an orderly and timely fashion.

   Prudent refinancing, renewal, workout, and modification programs are generally in the long-term best interest of both the financial institution and the borrower. Financial institutions must ensure regulatory reports and financial statements are prepared in accordance with generally accepted accounting principles and regulatory reporting instructions. Reporting should fairly present a financial institution's condition and performance, including an appropriate ALLL for HELOC exposures and appropriate accounting and disclosure for TDR loans.

Financial institutions must also comply with applicable consumer protection laws, which include, but are not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, federal and state prohibitions against unfair or deceptive acts or practices (such as section 5 of the Federal Trade Commission Act), the Real Estate Settlement Procedures Act, the Servicemembers Civil Relief Act, and the Truth in Lending Act (TILA), and the regulations issued pursuant to those laws. For example, TILA limits the circumstances under which a creditor may prohibit additional extensions of credit or reduce the credit limit applicable to HELOCs and sets forth related requirements for notice to affected consumers.[13]

6. **Establishing clear internal guidelines, criteria, and processes for end-of-draw actions and alternatives (renewals, extensions, and modifications).** Even financial institutions with moderate volumes of HELOCs nearing their end-of-draw periods should direct borrowers to trained customer account representatives familiar with the characteristics of the products, the borrower and property information needed, and the range of alternatives available. Refinance options should designate targeted products, terms, and qualification standards, with exception processes and limits clearly noted. Management should establish and define clear loss mitigation steps, such as monthly payment targets, documentation requirements, and the order of modification steps, so that well-trained account representatives can quickly and efficiently process requests.

7. **Providing practical information to higher-risk borrowers.** Financial institutions that offer loan modifications or other options to borrowers having financial difficulties should provide practical information that explains the basic options available, general eligibility criteria, and the process for requesting a modification. Such information should be clear and easily accessible to borrowers and should include information on how to contact the lender or servicer to discuss programs that might best fit the individual borrower's specific needs.

8. **Establishing end-of-draw reporting that tracks actions taken and subsequent performance.** Management should structure and distribute end-of-draw period reports to allow all involved personnel to understand and respond to exposures, activity, and performance results. Reporting should track end-of-draw period actions and subsequent account performance in the aggregate and separately by response type. Response types should include transition according to contract, short-term extensions, temporary modifications, permanent modifications, and renewals into new draw periods or longer- term amortization. Reporting should be frequent and contain a sufficient amount of detailed information to provide timely feedback to management, including exceptions to thresholds or guidelines that prompt additional analysis or actions.

9. **Documenting the link between ALLL methodologies and end-of-draw performance.** ALLL methodologies should consider potential HELOC default risk from payment shock, loss of line availability, and home value changes. Higher-risk borrowers whose HELOCs are nearing their end-of-draw periods generally pose greater repayment risk for ALLL purposes, and management should monitor them separately for appropriate consideration in the ALLL estimation process.

10. **Ensuring that control systems provide adequate scope and coverage of the full end-of-draw period exposure.** Commensurate with the volume of the financial institution's

HELOC exposure, management should have quality assurance, internal audit, and operational risk management functions perform appropriate targeted testing of the full process for managing the end-of-draw transactions. Even when an institution outsources all or a portion of the HELOC management, the financial institution remains responsible for ensuring that the service provider complies with applicable laws, regulations, and supervisory guidance. Testing should confirm that:

- draw terms and interest-only periods are not extended without credit approval.
- servicing systems accurately consolidate balances, calculate required payments, and process billing statements for the full range of potential HELOC repayment terms that exist once draw periods end.
- staffing and resources can efficiently handle expected volumes and the breadth and scope of program activities.
- borrower notifications of upcoming draw period expirations are timely and made in accordance with contractual terms and management guidelines.
- reports provide reliable and timely information that enables management to monitor and evaluate end-of-draw activities.

Financial institutions with a significant volume of HELOCs, portfolio acquisitions, or exposures with higher-risk characteristics generally should have comprehensive systems and procedures to monitor and assess their portfolios. Community banks and credit unions with small portfolios of HELOCs, few portfolio acquisitions, or exposures with lower-risk characteristics may be able to use existing less-sophisticated processes.

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[1] The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC).

[2] OCC Bulletin 2005-22, "Home Equity Lending: Credit Risk Management Guidance" at http://www.occ.gov/news-issuances/bulletins/2005/bulletin-2005-22.html; FRB SR letter 05-11, "Interagency Credit Risk Management Guidance for Home Equity Lending" at http://www.federalreserve.gov/boarddocs/srletters/2005/SR0511.htm; FDIC FIL-45-2005, "Credit Risk Management Guidance for Equity Lending" at http://www.fdic.gov/news/news/financial/2005/fil4505.html; and NCUA Letter to Credit Unions 05-CU-07, "Joint Statement—Credit Risk Management Guidance for Home Equity Lending" at http://www.ncua.gov/Resources/Documents/LCU2005-07.pdf.

[3] OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation" at http://www.occ.gov/news-issuances/bulletins/2000/bulletin-2000-20.html; FRB SR letter 00-8, "Revised Uniform Retail Credit Classification and Account Management Policy" at http://www.federalreserve.gov/boarddocs/srletters/2000/SR0008.HTM; and FDIC Statements of Policy at http://www.fdic.gov/regulations/laws/rules/5000-1000.html#fdic5000uniformpf. Charge-off policy guidance for credit unions is set forth in NCUA Letter to Credit Unions 03-CU-01, "Loan Charge-off Guidance" at http://www.ncua.gov/Resources/Documents/LCU2003-01.pdf.

[4] OCC Bulletin 2013-26, "Troubled Debt Restructurings: Guidance on Certain Issues Related to Troubled Debt Restructurings" at http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-26.html; FRB SR letter 13-17, "Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructurings" at http://www.federalreserve.gov/bankinforeg/srletters/sr1317.htm; FDIC FIL-50-2013, "Troubled Debt Restructurings Interagency Supervisory Guidance" at https://www.fdic.gov/news/news/financial/2013/fil13050.html; and NCUA

Letter to Credit Unions 13-CU-03, "Supervisory Guidance on Troubled Debt Restructuring" at http://www.ncua.gov/Resources/Pages/LCU2013-03.aspx.

[5] OCC Bulletin 2012-6, "Interagency Guidance on ALLL Estimation Practices for Junior Liens on 1-4: Guidance on Junior Liens" at http://www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-6.html; FRB SR letter 12-3, "Interagency Guidance on Allowance Estimation Practices for Junior Lien Loans and Lines of Credit" at http://www.federalreserve.gov/bankinforeg/srletters/sr1203.htm; FDIC FIL-4-2012, "Estimation Practices for Junior Liens on Residential Properties" at http://www.fdic.gov/news/news/financial/2012/fil12004.html; and NCUA Accounting Bulletin 12-1 transmitting interagency guidance at http://www.ncua.gov/Legal/GuidesEtc/AccountingBulletins/AcctBul12-1.pdf.

[6] FFIEC: Instructions for the Consolidated Reports of Condition and Income, Glossary, at http://www.ffiec.gov/pdf/ffiec_forms/ffiec031_041_200503_i.pdf; and NCUA Letter to Credit Unions 13-CU-03, "Supervisory Guidance on Troubled Debt Restructuring" at http://www.ncua.gov/Resources/Pages/LCU2013-03.aspx.

[7] FRB: 12 CFR 208, subpart E and appendix C to subpart E (state member banks). OCC: 12 CFR 34, subpart D and appendix A to subpart D (national banks); and 12 CFR 160.101 and appendix to 160.101 (federal savings associations). FDIC: 12 CFR 365, subpart A and appendix A to subpart A (state nonmember banks); 12 CFR 390.265 and appendix (state savings associations). The NCUA is not a participant in this guidance.

[8] The terms renewal, extension, and rewrite (modification) are defined in "The Uniform Retail Credit Classification and Account Management Policy". The NCUA defines these terms similarly in "Interpretive Ruling and Policy Statement on Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans", at 12 C.F.R. 741, appendix C *"Glossary,"* footnote 19.

[9] For example, the U.S. Department of the Treasury's Second Lien Modification Program (2MP) provides a mechanism for lenders to modify second liens when a homeowner receives a first lien modification through the Home Affordable Modification Program (HAMP). Details on 2MP are available on the Second Lien Modification Program page at http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/lien_modification.aspx.

[10] Refer to Financial Accounting Standards Board *Accounting Standards Codification* section 310-40-15. Generally, a high CLTV by itself is not an automatic indicator of a borrower's financial difficulties. A high CLTV, however, may indicate a higher probability of default upon payment reset and therefore may affect the assessment of whether a modification of the terms of a HELOC nearing its end-of-draw period constitutes a TDR.

[11] First-lien modification programs include Treasury's HAMP, streamlined or standard modifications for government-sponsored enterprise mortgages, programs established by state housing finance agencies individually or under Treasury's Hardest Hit Fund initiative, or proprietary efforts.

[12] A lockout refers to a fixed-rate option on an otherwise variable-rate line of credit. In a lockout arrangement, a borrower has the option to convert a portion of the outstanding balance to a fixed rate of interest for a specified period of time. Lockout balances are deducted from line availability until repaid, and normally amortize over one-to-20 years depending on the amount of the advance.

[13] 12 C.F.R. 1026.40(f)(3)(i) and 1026.40(f)(3)(vi); 12 C.F.R. 1026.9(c)(1)(iii).