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18 December 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20 and C Streets, NW
Washington, D.C. 20051

Re: **Docket Number R-1370**
Regulation Z
Truth in Lending Act
74 *Federal Register* 43428 August 26, 2009

The American Bankers Association (ABA) [1] is pleased to provide our comments on the Federal Reserve Board's (Board) proposed changes to amend Regulation Z. The Board proposes changes to the format, timing, and content requirements for the four main types of home equity lines of credit (HELOCs) disclosures: application disclosures; account opening disclosures; period statements; and change-in-terms notices. In addition, the Board proposes to provide additional guidance on when a creditor may terminate an account or temporarily suspend advances on a HELOC or reduce the credit limit, and what a creditor's obligations are concerning reinstating such accounts.

Generally, we appreciate and support the Federal Reserve Board's efforts and its extensive consumer research that will improve the disclosures and help to ensure that HELOC disclosures are relevant and understandable to consumers. ABA has always encouraged simple disclosures that highlight the most important information and that use terms people understand. Most of our concerns focus restrictions that hamstring banks and may require them to continue to make loans despite indications that repayment of the loan is at risk. We also focus on the compliance burdens which will add risks and costs that create more pressure for banks, particularly small banks, to exit the HELOC market.

[1] The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

We strongly caution the Board not to restrict further the ability of banks to suspend additional credit or close accounts when conditions indicate that the customer is likely to struggle or be unable to repay the loan or that the value of the property does not support additional credit. Given recent and current economic events related to the inability of some borrowers to repay mortgage loans, the fact that some borrowers are "upside down" in their mortgages or in foreclosure, it would seem to be an odd time to be compelling banks to provide home-secured credit under what appears to be risky circumstances. It is not simply a matter of protecting the lender: it does not help borrowers, lenders – or the general economy. A liberal lending approach also would be inconsistent with recent amendments to the Truth in lending Act under the Credit CARD Act which specifically prohibit opening credit card accounts without considering the applicant's ability to repay, and in the case of people under 21 years of age, the applicant's "independent" ability to repay.

In addition, the Board should recognize that compliance with these proposed, more complicated and demanding requirements is not simply a question of contracting with a vendor or installing software to produce instantaneous, accurate disclosures that are provided at the appropriate time. Bank personnel must themselves review and understand the rules, devise an implementation plan, and ensure any product or service provided in-house or by an outside vendor complies. They must also train numerous personnel throughout the bank about yet one more complicated rule to ensure they understand the rule and their duties. Through the implementation and continuing compliance process, banks must integrate and coordinate this rule with numerous other regulations that also apply to HELOCs. Finally, they must periodically audit for compliance, prepare for examinations, and defend policies and compliance implementation to examiners. Accordingly, the Board should be sensitive about unnecessary complications that increase the risk of noncompliance and liability.

§ 226.5b Requirements for home-equity plans:

(c) Content of disclosures.

Under the proposal the Board is replacing the disclosure of generic rates and terms currently required with the "early disclosures" with a "transaction-specific" disclosure that must be given within three days after application. This disclosure would:

- Provide information about rates and fees, payments and risks in a tabular format;
- Highlight whether the consumer will be responsible for a balloon payment; and
- Present payment examples based on both the current rate available and the maximum possible rate for the HELOC.

The disclosure must include the annual percentage rate (APR), key terms, and the credit limit. If the creditor offers more than one payment option, the creditor may only disclose two payment plans. Model disclosures are provided.

The proposed Commentary requires creditors to disclose any terms that are subject to change prior to account opening. The model disclosure inserts this statement at the end of the disclosure. Given the importance of this information and to avoid any confusion or false expectations on the part of the consumer, we strongly recommend that this provision be provided in a location where the consumer is more likely to notice it, that is, ***before and in close proximity*** to the good faith estimates.

Moreover, to avoid confusion, the regulation itself should make clear that the disclosures are good faith estimates. Ambiguity may lead to an interpretation that the disclosures are binding. Producing binding transaction-specific disclosures within three days would be expensive and challenging, and in some cases, not feasible. The result would be pressure for some institutions, particularly small institutions, to exit the business. We are already hearing from small institutions who will no longer be offering closed-end mortgages because of the new Real Estate Settlement Procedures Act requirements and Regulation Z provisions related to mortgages. If it is not clear that the proposed HELOC disclosures are good faith estimates and not a binding offer, some banks may be compelled to take similar actions with regard to HELOCs if the requirements become too burdensome, complicated, and costly.

Finally, we suggest that the Board allow more flexibility in disclosing payment options. Under the proposal, if more than one repayment option is offered, the creditor must disclose only two payment plan options in the table. If more than two options are offered, the creditor must disclose that other payment plans are available and that the consumer should ask for additional details. In addition, creditors must disclose in the table fairly lengthy, complicated information related to the payment plan or for two plans if more than one plan is available. Creditors must provide sample payments for both options showing the first minimum periodic payment for the draw period and any repayment period and the balance outstanding at the beginning of any repayment period based on certain assumptions. Two sample payments for each plan (up to two plans) must be provided based on the current APR and the maximum APR. In addition, the notice must indicate whether a balloon payment is involved, the amount of any balloon, and identify which plan results in the least amount of interest and which results in the most amount of interest

We appreciate that the Board is trying to balance the goal of providing details of important and relevant information with the goals of not cluttering disclosures and not complicating compliance so as to limit consumer choice. We believe that the Board can meet all those goals by permitting creditors to provide the repayment terms of different programs on separate documents.

Given the transaction specificity of the disclosures, providing the tailored disclosures on a single disclosure from a programming perspective is very challenging and expensive. Accordingly, some institutions would in effect be limited to offering only one plan. The result is fewer choices and less flexibility for consumers. Allowing these tailored, detailed disclosures to be on separate documents would make compliance simpler and give consumers more choice.

In addition, since lenders may provide additional payment options upon the consumer’s request and those disclosures are presumably in the same format, it is not clear why two payment plan examples must be presented in the same form. The determination of which two plans will be in the disclosures will be somewhat arbitrary, and the notice inviting them to ask about other options as well as human behavior will incline consumers to ask about options. Accordingly, they are likely to receive other options on separate disclosures if there are more than two plans. If consumers will be comparing payment options using separate disclosures for some plans, why may they not do it for all? Moreover, separate disclosure of these important terms may enhance and highlight them so as to increase their visibility and the likelihood of a closer review.

We appreciate that the single comparative disclosure is also intended to advise consumers about the relative expenses of two plan options. This could be addressed by a more generic disclosure that borrowers will pay more interest on some plans, that those with balloon payments are usually more expensive, and that the customer should inquire.

(f) Limitations on home-equity plans.
(2) Termination of plan

Section 226.5b(f) limits the changes that creditors may make to HELOCs subject to Section 226.5b. Those limitations include: limitations on actions that may be taken when customers fail to meet the repayment terms; limitations on temporary suspensions of credit or reductions of credit limits if there is a significant decline in the property value or a material change in the customer's financial circumstances; and limitations on changes in terms. The Board proposes to clarify when creditors may close accounts and suspend additional draws.

In reviewing the proposed increased restrictions on lowering limits or closing accounts, the Board should keep in mind that creditors have no incentive arbitrarily to suspend lines of credit or close accounts: they are in the business of making loans and want to make loans that are likely to be repaid. However, it does not help the customer or the bank if the bank is compelled to make loans that the customer will struggle to repay or will be unable to repay, as recent economic events have vividly demonstrated. Nor is permitting suspensions of additional credit intended only to protect the lender against losses. It also protects customers from harm. In addition to the usual adverse consequences to borrowers when they are unable to repay a loan, for HELOCs, they risk losing their home. These negative aspects of default increase the need for caution in allowing additional credit secured by a home when there are indications that the customer's financial situation has deteriorated or the value of the home has declined. Indeed appropriate suspension of additional credit encourages prudent financial management.

Under the statute, creditors may not "unilaterally terminate any account . . .except in the case of . . .(2) failure by the consumer to meet the repayment terms of the agreement for any outstanding balance." The current regulation permits creditors to terminate a HELOC and accelerate the balance if the consumer has "fail[ed] to meet the repayment terms of the agreement for any outstanding balance." The proposal provides that only a late payment of at least 30 days may trigger terminating an account or suspending additional draws.

Most banks currently do not terminate a HELOC and accelerate repayment based solely on the fact that a payment is late by 30 days or less. Nor do they typically suspend additional draws based solely on such a late payment. However, they might on occasion if other factors exist. While another provision of the regulation permits creditors to suspend additional draws, those circumstances are limited, and there may be factors other than those permitted, which, when combined with a payment that is late by 30 days or less, indicate that it is imprudent to make the loan. We do not see any reason that creditors should not have that flexibility under these circumstances.

The Board has asked whether 30 days is appropriate and notes “that the 2009 Credit CARD Act. . . has suggested considering a delinquency threshold of more than 60 days.” If the Board adopts a threshold, it should not be longer than 30 days. Unlike credit cards which have comparatively low minimum payments, HELOC’s minimum payments tend to be higher so that it is more difficult for borrowers to catch up and become current. In addition, the 60-day rule applicable to credit cards does not relate to suspensions of credit – the Credit CARD Act put no limitations on closing accounts or suspending additional draws. Rather it relates to whether creditors may charge a higher rate on “existing” balances. There simply is no relationship between the Credit CARD provision about rate increases and a decision on whether a creditor should continue to lend if there are indications the loan will not be repaid.

We also suggest that the Board clarify in the regulation itself that creditors may take the lesser step of suspending additional credit rather than closing the account and accelerating payment if the customer fails to meet the repayment requirements.

(3) Change in term limitations

This section generally prohibits creditors from changing the terms of a HELOC plan after it is opened. However, there are exceptions. Among the exceptions are suspensions of credit based on a significant decline in the value of the dwelling securing the plan or a material change in the consumer’s financial circumstances,” and beneficial and insignificant changes. The Board is providing additional clarification on the meaning of these exceptions.

The Commentary currently provides that whether a decline in value is significant “will vary according to the individual circumstances.” It also provides a safe harbor standard for determining whether a decline is significant. Specifically, a decline in value is considered significant if it results in the initial difference between the credit limit and the available equity diminishing by 50 percent or more. The Board is proposing two safe harbors:

1. For plans with a combined loan-to-value of 90 percent or higher, a five percent reduction in the property value would constitute a significant decline in value.

2. For plans with a combined loan to value for origination under 90 percent, the Board proposes to retain the existing safe harbor, under which a decline in the value of the property is significant if, as a result of the decline, the initial difference between the credit limit and the available equity (based on the property's value for purpose of the plan) is reduced by 50 percent.

While most banks do not and did not make HELOCs with less than ten percent equity, lenders making such loans should not be constrained as proposed in suspending additional credit when the property value has fallen less than five percent. Even if the equity has fallen by less than five percent, such a decline still makes these loans significantly riskier and puts borrowers more at risk of losing their home than they were prior to the decline. While the actual amount of a value reduction may be less for loans made with a ten percent equity or less than those with more equity, a fifty percent decline in property value for these loans is just as, if not more, significant than such a decline for loans with higher equity. In other words, relatively speaking, even if the decline is a lower dollar amount, it is still as significant because there was less equity to begin with, so there is greater risk. For these reason, we suggest that the Board not adopt the proposed second safe harbor, but retain the existing one.

The Board is also proposing to make clear that in determining whether there has been a reduction in the value of the dwelling that appraisals are not required and that automated value models, tax assessment valuations, and broker price opinions are acceptable. We strongly agree. Requiring expensive and time-consuming appraisals is unnecessary and inappropriate. The alternative methods are sufficient for this limited purposes and the lower cost means that customers pay less, either directly or indirectly.

This section also permits creditors to suspend advances or reduce the credit limit when "the creditor reasonably believes that the consumer will be unable to fulfill the repayment obligations of the plan because of a material change in the consumer's financial circumstances." The Board has asked for comment on how the regulation might make clearer the meaning of this standard, noting that both creditors and consumer groups have expressed dissatisfaction that it provides sufficient guidance. Specifically, the Board has asked whether it should interpret the "unable to pay" standard to mean that the change in the consumer's financial circumstances resulted in the likelihood of default "substantially" increasing. It also suggests a possible interpretation that the standard requires that, as a result of a change in the consumer's financial circumstances, the consumer moved into a higher default risk category than at origination, such that the creditor would not have made the loan or would have made the loan on materially less favorable terms and conditions.

While we appreciate the Board's efforts to address concerns and offer more clarity, we believe that endorsing any particular approach, including those offered, will simply be as subjective and subject to challenge as the existing standard. For example, a standard based on a "substantially increasing likelihood of default" does not necessarily help the customer or the lender as it may be represented by a variety of measures, especially when evaluated in different economic environments or when agency underwriting requirements, for example, may have changed. Moreover, we object to such a standard as it would be so restrictive that it would virtually guarantee that imprudent draws will be made. Similarly, a standard based on "default risk categories" would be difficult to interpret because default risk categories are subject to change. Unless it is very clear that any standards are simply *examples* of factors to consider and that the standard is not limited to these examples, the regulation will simply compel banks to make imprudent loans based on an artificial and narrow standard and expose them to unnecessary potential liability for good faith decisions.

Neither the current regulation nor the proposal address whether a change in a credit score is a "material change" in the borrower's financial circumstances. While banks often use credit scores as a tool in HELOC reviews because they are very predictive, they generally only use them as a reason to take a closer look at the loan and the borrower. Some components of the score are relevant, e.g. late payments and increased borrowing, but others, such as the number of inquiries may not be. At this time, we suggest that the regulation not address credit scores or provide examples as they become the *de facto* rule and become unnecessarily rigid and ineffective.

The proposal clarifies that a change in terms notice is required when temporarily reduced rate or fees are returned to their original level if the subsequent increases were not in the agreement. We suggest that the regulation clarify that "agreement" does not refer to the original agreement, but to the agreement to the lower rate.

The Board asks whether the regulation should set a general standard for insignificant term changes. We recommend against setting standards as they would invariably be too subjective and subject to challenge and therefore not particularly helpful. We are not aware that there have been complaints or debates among customers or lenders.

(g) Reinstatement of credit

Under the regulation, if a creditor prohibits additional extension of credit or reduces the credit limit, the creditor must reinstate credit privileges as soon as reasonably possible after the condition that caused the creditor's action no longer exists. The creditor may monitor the line or require the customer to request reinstatement. The proposal provides that the customer may not be charged with the first reinstatement request.

The Board requests comment on whether the regulation should require ongoing monitoring in all cases rather than give creditors the option to require customers to request reinstatement as currently allowed. Lenders have a natural incentive to reinstate a loan as soon as prudent. They are in the business of making loans and pleasing customers. Therefore, we expect that they will naturally reinstate the loans as soon as practicable and appropriate. However, imposing a requirement to monitor for all customers' property values and financial circumstances creates another level of expensive and subjective compliance as well as potential liability for good faith decisions. Moreover, it would be particularly burdensome for small institutions that might not have the resources to install the necessary sophisticated systems to ensure that all borrowers and property values are continuously monitored appropriately. It might also inhibit lenders from lowering limits or suspending additional credit in circumstances when prudence suggests that they should. Accordingly, we recommend that the Board retain the current flexibility and permit lenders to require their customers to request reinstatement.

The Board also asks whether customers should have to pay for subsequent reinvestigations, for example, every six months. For creditors who determine property values based on automated valuation models, subsequent reinvestigations without charge do not present an excessive burden. However, some institutions prefer to rely on appraisals, which are expensive. Mandating a "free" investigation will encourage reinvestigation requests. If lenders must absorb the costs, they may be inhibited from using appraisals. Therefore, we suggest that the regulation strike a balance and provide that customers not pay for subsequent reinvestigations if in fact the lender determines that reinstatement is appropriate. This gives the borrower an incentive to exercise some judgment, but relief if reinstatement is warranted.

In addition, the regulation should not encourage abuse. If free reinvestigations are permitted, they should not be permitted more than once per year. Property values often rise more slowly than they decrease and in general little changes within six months, or even years. Banks are already required to review values annually for capital requirements, so one year would be an appropriate interval.

The proposal appears to delete the current provision in the Commentary which permits creditors to require that the request be in writing. We urge the Board to reinstate this requirement. It helps to protect both lenders and their customers by ensuring that there is documentation of the request so that there is no debate about whether the customer made the request or whether the creditor has met its obligations in a timely fashion.

Conclusion

ABA appreciates and supports the Board's efforts to simplify and improve the disclosures for HELOCs to ensure that consumers are better able to shop for loans and understand their terms. Overall, we believe that the Board has accomplished its goal.

We are mostly concerned that the regulations not compel banks to make loans in spite of indications that the customer will struggle or be unable to repay the loan, especially as they risk losing their home. In addition, we urge the Board to be mindful of the compliance burdens and complexities which add risks and costs that add to pressure to discontinue offering HELOC products.

Regards,

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