



Office of Thrift Supervision

Department of the Treasury

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December 18, 2009

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

SUBJECT: Comments on Proposed Amendments to Regulation Z
Docket No. R-1367

Dear Ms. Johnson:

The Office of Thrift Supervision (OTS) has reviewed the Federal Reserve Board's proposed amendments to Regulation Z concerning home equity lines of credit (HELOCs). We are encouraged by the many aspects of the August 26, 2009 proposed rule that provide consumers with greater protections in connection with HELOCs. To provide assistance with this effort, we have enclosed our comments on the proposed rule.

If you have any questions regarding our comments, please contact April Breslaw, Consumer Regulations Director at (202) 906-6989; Rhonda Daniels, Senior Compliance Program Analyst at (202) 906-7158; or Richard Bennett, Senior Compliance Counsel at (202) 906-7409.

Sincerely,

Montrice Godard Yakimov

Enclosure

Office of Thrift Supervision
Staff Commentary on Proposed Regulation Z Amendment
FRB Docket R- 1367

The Office of Thrift Supervision (OTS) is taking this opportunity to comment on proposed revisions to the Regulation Z requirements that implement the Truth in Lending Act (TILA)¹ for open-end home secured credit or home equity lines of credit (HELOCs).² Through this rulemaking, the Board proposes to better protect consumers by: (1) improving the process through which a creditor may temporarily suspend HELOC advances or reduce a credit limit; (2) improving the process through which a consumer's HELOC privileges may be reinstated; and (3) restricting the ability of a creditor to terminate a HELOC plan for payment-related reasons. The Board has also proposed changes to the HELOC disclosures governed by Regulation Z.

I. Suspending Advances and Reducing Credit Limits

A. Actions Based on Significant Property Value Decline,
Including Reinstating Credit Privileges When Circumstances Change

Regulation Z permits a creditor to temporarily suspend advances or reduce a HELOC credit line if the “value of the dwelling that secures the plan declines significantly below the dwelling’s appraised value for purposes of the plan.”³ However, credit privileges must be reinstated in a timely manner if these circumstances cease to exist.⁴ OTS has received many consumer complaints about the way in which “freezes” and reductions have been implemented, and the difficulty consumers experience as they attempt to obtain reinstatement of their credit privileges. We therefore support the Board’s effort to improve this entire process. Specifically, OTS endorses the Board’s proposal to:

- Clarify that, at minimum, a creditor must assess the value of property based on its specific characteristics to determine whether a “significant decline” has occurred.⁵
- Clarify that in addition to an appraisal, property valuation methods including, but not limited to, automated valuation models, tax assessment valuations and broker price opinions may be used to determine “significant decline.”⁶

¹ 15 U.S.C. § 1601 et seq.

² 74 Fed. Reg. 43428 (Aug. 26, 2009).

³ 12 C.F.R. § 226.5b(f)(3)(vi)(A).

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

⁵ See proposed 12 C.F.R. pt. 226, Supp. I, comment 226.5b(f)(3)(vi)-4.

⁶ See proposed 12 C.F.R. pt. 226, Supp. I, comment 226.5b(f)(3)(vi)-5.

- Move creditor notice and investigation requirements from staff commentary into Regulation Z, including the requirement that creditors investigate and transmit their responses to reinstatement requests within 30 days of receipt.⁷
- Require a creditor to notify a consumer in writing of the results of a requested reinstatement investigation when the results show that reinstatement is not warranted.⁸
- Require a creditor, upon a consumer's request for reinstatement, to provide a copy of the documentation that supports the property value on which the creditor relied to freeze or reduce the line, or to continue an existing freeze or reduction.⁹
- Clarify that when a creditor investigates whether a significant decline in property value exists,¹⁰ the creditor should reassess the value of the property securing the line based on an updated property valuation.
- Revise Regulation Z to grant a consumer one reinstatement request free of charge.¹¹

OTS Recommendations

As we explained in our recent guidance on HELOC account management,¹² while Regulation Z does not require a savings association to obtain an appraisal to determine whether collateral value has significantly declined, an association should have a sound factual basis for reaching this conclusion.¹³ Consistent with this approach, the OTS recommends that the Board require a creditor to consider sound property valuation evidence submitted by a consumer before making a reinstatement determination.

We submit this recommendation in response to persistent complaints that when consumers attempt to obtain reinstatement by providing documentation that demonstrates that no significant decline in property value has occurred, this information is either rejected or disregarded by creditors. While the weight afforded such evidence should be governed by prudent risk management principles,¹⁴ reasonable documentation should not be ignored. Just as the Board proposes to permit creditors to rely on valuation methods that include, but are not limited to, appraisals, automated valuation models, tax assessment valuations, and broker price opinions to determine "significant decline,"¹⁵

⁷ See proposed 12 C.F.R. § 226.5b(g)(1) and (g)(2).

⁸ See proposed 12 C.F.R. § 226.5b(g)(2)(v).

⁹ See proposed 12 C.F.R. § 226.5b(g)(3).

¹⁰ See proposed 12 C.F.R. pt. 226, Supp. 1, comment 226.5b(g)(2)(ii)-1.

¹¹ See proposed 12 C.F.R. § 226.5b(g)(2)(iii).

¹² See "Home Equity Line of Credit Account Management Guidance," August 2008, available at <http://files.ots.treas.gov/481121.pdf>.

¹³ *Id.*, at p. 3.

¹⁴ See "Credit Risk Management Guidance for Home Equity Lending," issued by the federal financial regulatory agencies on May 16, 2005, available at <http://files.ots.treas.gov//25222.pdf>.

¹⁵ See 12 C.F.R. pt. 226, Supp I, comment 226.5b(f)(3)(vi)-5.

consumers should be permitted to submit this range of evidence for consideration when reinstatement is requested.

OTS also recommends that the initial notice concerning suspension or reduction of a HELOC should inform a consumer that he or she may submit documentation concerning property valuation to the creditor and that such information will be considered as a reinstatement determination is made. Such a notice should inform consumers of the type of documentation that the creditor will take into account for this purpose.

B. Material Change in a Consumer's Financial Circumstances

Regulation Z permits a creditor to suspend advances or reduce a HELOC credit limit when “the creditor reasonably believes that the consumer will be unable to fulfill the payment obligations of the plan because of a material change in the consumer’s financial circumstances.”¹⁶ OTS supports the Board’s effort to clarify how creditors may determine when a material change in financial circumstances has occurred,¹⁷ as well as its effort to ensure that actions taken on this basis are equitable. Specifically the Board proposes to require that these payment failures must occur within a “reasonable time” from the date of the creditor’s review of the consumer’s credit performance in order to form the basis for freezing or reducing a HELOC.¹⁸ The Board proposes a safe harbor of six months for determining whether a payment failure occurred within a “reasonable time” from the date of the creditor’s review.¹⁹ OTS endorses this approach.

II. Account Termination

Currently, Regulation Z permits a creditor to terminate a HELOC for several reasons, including when the consumer has failed to meet the repayment terms of the agreement for any outstanding balance.²⁰ The proposal would interpret the statute to mean that creditors may not terminate the plan and accelerate the balance unless the consumer has failed to make a required minimum periodic payment within 30 days after the due date for that payment.²¹ As this approach is intended to protect consumers from terminations based on minor payment infractions, OTS fully supports it.

III. HELOC Disclosures

The Board has proposed format, timing and content changes to make the disclosures currently required at application more meaningful and easier for consumers to use.²² In addition, the Board has proposed improvements to periodic statement requirements.²³ Finally, the Board has proposed to require creditors to provide HELOC

¹⁶ 12 C.F.R. § 226.5b(f)(3)(vi)(B).

¹⁷ See proposed 12 C.F.R. pt. 226, Supp. I, comment 226.5b (f)(3)(vi)-6.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ 12 C.F.R. § 226.5b(f)(2)(ii).

²¹ See proposed 12 C.F.R. § 226.5b(f)(2)(ii).

²² See proposed 12 C.F.R. §§ 226.5b and 226.6 and proposed commentary to 226.5b and 226.6.

²³ See proposed 12 C.F.R. § 226.7(a) and proposed commentary to 226.7(a).

customers with 45 days notice before significant changes in significant account terms are imposed.²⁴ The OTS supports all of these proposals. However, we have concerns about certain aspects of the disclosure regime proposed.

A. Disclosures at Application and Account Opening

Under the Board's proposal, the current application disclosures of generic rates and terms would be replaced with transaction-specific HELOC disclosures that must be given within three business days after application, but not later than account opening.²⁵ This early HELOC disclosure would provide information about rates and fees, payments, and risks in a tabular format designed to make the information simpler for consumers to absorb. However, late payment fees, over-the-limit fees, transaction charges, returned-payment fees, and fees for failure to comply with transaction limitations would not have to be stated.²⁶ In addition, the table in the early HELOC disclosure would only acknowledge the possibility of a balloon payment or negative amortization if these features are applicable to the loan offered at application.²⁷

In contrast to the early disclosures, creditors would be required to include information about the fees noted above at account opening.²⁸ If the loan offered at account opening has a balloon payment or negative amortization feature, the account opening disclosures would be required to so indicate in a table.²⁹ Separately, the Board proposes to require creditors to include a statement in account opening disclosures that describes when they will take actions such as terminating a HELOC plan or changing its terms.³⁰

OTS Recommendations

Consumers should be able to directly compare the disclosure provided within three days of application with the disclosure provided at account opening. Such a comparison will be difficult if these documents do not require consistent information about fees and the existence of material features such as balloon payments or negative amortization. Absent such information in the early HELOC disclosure, a consumer that received a later disclosure indicating that such features are part of his or her transaction could be vulnerable to misleading explanation from the lender about the change in terms. Consequently, we recommend that the early disclosure be amended to include commonly assessed fees and affirmatively state whether the terms of the plan include a balloon payment or negative amortization, or not.

In addition, while OTS supports the Board's proposal to require creditors to include a statement in account opening disclosures that describes when they will take

²⁴ See proposed 12 C.F.R. § 226.9(c).

²⁵ See proposed 12 C.F.R. § 226.5b(b)(1).

²⁶ See proposed 12 C.F.R. pt. 226, Supp. 1, comment 226.6(a)(1)-1(ix).

²⁷ See proposed §§ 226.5b(c)(9) and (c)(15) and proposed comment 226.5b(c)-1.

²⁸ See proposed 12 C.F.R. §§ 226.6(a)(1)(i) and 226.6(a)(2)(x)-(xiv).

²⁹ See proposed 12 C.F.R. §§ 226.6(a)(1)(i), (a)(2)(v) and (a)(2)(xvi).

³⁰ See proposed § 226.6(a)(5)(iv).

actions such as terminating a HELOC plan or changing its terms, we strongly encourage the Board to test how such information can be effectively conveyed to consumers. Based on our experience with consumer complaints and inquiries, many borrowers are unaware that their creditors reserve the right to take these actions if their financial situation changes, if the property value declines, or if they fail to meet the repayment terms of the loan.³¹ To ensure that consumers have a reasonable understanding of when their HELOC may be terminated, suspended or reduced, we recommend that creditors be required to disclose such information in a meaningful way at account opening.

B. Two Cycle Billing

Currently, account opening disclosures must explain the method that a creditor uses to determine the balance to which rates are applied.³² Under the proposal, the account opening disclosures would provide only the name of the balance computation method used for each feature of the account, along with a statement that notes where in the account agreement or other documents an explanation of the balance computation method can be found.³³ The Board apparently believes that this approach will effectively communicate information about the balance computation method without distracting consumers from other information included on the account-opening table.³⁴

This theory should be tested with consumers, particularly since the Board is taking a somewhat different approach to providing this information on periodic statements. In that context, the Board proposes to allow creditors to either explain the balance computation method used or identify the method and provide a toll free number for consumers to call for information about how the balance was calculated and resulting interest charges were determined.³⁵ The second option seems to have been proposed in response to Board research conducted in connection with credit card disclosures finalized through amendments to Regulation Z earlier this year.³⁶ That research showed that consumers are not likely to try to comprehend the applicable balance computation method by reading an explanation. Instead, they told the Board that they would call a creditor to discuss this type of question.³⁷ Consumers may gravitate to this approach because they find balance computation methods difficult to understand. As explained below, the two cycle billing method raises noteworthy problems in this regard. The Board continues to allow this balance computation method.³⁸

³¹ Although some HELOC agreements include this information, others state only that a creditor reserves the right to reduce, suspend, or terminate a HELOC “as permitted by law.”

³² 12 C.F.R. § 226.6(a)(3).

³³ See proposed 12 C.F.R. § 226.6(a)(2)(xxii).

³⁴ 74 Fed. Reg. at 43504.

³⁵ See proposed § 226.7(a)(5).

³⁶ 74 Fed. Reg. at 43511.

³⁷ *Id.*

³⁸ See 12 C.F.R. § 226.5a(g) (includes “two-cycle average daily balance” in list of commonly used balance computation methods).

OTS Recommendation

As you know, the Agencies generally prohibited two-cycle billing as an unfair credit card practice in their 2009 rulemaking³⁹ and Congress generally banned it for credit cards through the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act).⁴⁰ Notably, the preamble to the Agencies' rule specifically states that "because the Board's consumer testing indicates that disclosures are not successful in helping consumers understand balance computation methods, a disclosure would not enable consumers to avoid the two-cycle method when comparing credit card accounts or to avoid the effects of the two-cycle method when using a credit card."⁴¹ The Board does not appear to have conducted new research that shows that consumers who obtain HELOCs are more able than consumers who obtain credit cards to understand how the two-cycle billing method works. Unless such research is conducted, OTS suggests that the Board consider using its authority⁴² to prohibit two-cycle billing for HELOCs as an unfair practice. This outcome would be consistent with the conclusion that the Board has reached in recent related rulemakings.

³⁹ See, e.g., 74 Fed. Reg. 5498, 5569 (Jan. 29, 2009) (promulgating § 535.25).

⁴⁰ Credit CARD Act § 102(a), adding a new § 127(j) to TILA (15 U.S.C. § 1637(j)).

⁴¹ 74 Fed. Reg. at 5536.

⁴² See TILA § 129(l)(2).