NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **May 2005** **LETTER NO.: 05-CU-07**

TO: **Federally Insured Credit Unions**

SUBJ: **Managing Risks Associated with Home Equity Lending**

ENCL: **Joint Statement—Credit Risk Management Guidance for Home Equity Lending**

Dear Board of Directors:

The National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (the agencies) are jointly issuing the enclosed credit risk management guidance for home equity lending. The agencies developed this document to promote sound risk management practices at financial institutions with home equity lending programs, including open-end home equity lines of credit (HELOCs) and closed-end home equity loans (HELs).

The rise in home values and low interest rates in recent years, as well as favorable tax treatment, have made home equity loans and lines attractive to members. For the year ended December 31, 2004, home equity lines of credit funded by federally insured credit unions increased 29 percent. HELOCs totaled $34 billion at the end of last year, approximately 8 percent of loans outstanding.

Typically, home equity loans are long-term with interest-only features that require no amortization of principal for a protracted period. HELOCs generally do not have interest rate caps that limit rate increases. Therefore, they are inherently vulnerable to rising interest rates. In addition, with the rise in home values and demand for home equity lending in recent years, many financial institutions relaxed underwriting standards associated with these loans, such as higher loan-to-value and debt-to-income ratios.

The enclosed guidance addresses prudent home equity loan marketing, underwriting, collateral valuation, and portfolio monitoring and management. For example, credit unions should conduct annual reviews of HELOC accounts to determine whether the line of credit should be continued, based on the borrower's current financial condition and the value of the collateral. Under Regulation Z, you can refuse to extend additional credit or reduce the credit limit of the HELOC under certain circumstances. These circumstances include a decline in collateral value significantly below the appraised value, a material change in the borrower's financial circumstances, and as a result of the change, it is reasonable to believe the member will be unable to fulfill the payment obligations.

Effective HELOC portfolio management includes analyzing the portfolio by segment using criteria such as product type, credit risk score, loan-to-value ratio, debt-to-income ratio, property type, geographic area, and lien position. In addition, you are encouraged to perform stress tests or sensitivity analyses on your HELOC portfolios. Without these types of analyses and monitoring tools, it will be difficult for your credit union to proactively mitigate potential loan delinquencies and losses in an environment with rising interest rates and declining home values.

The majority of information in the enclosed guidance applies to credit unions. However, due to field of membership restrictions, credit unions are not likely to go through brokers or correspondents to build a home equity portfolio. Furthermore, two interagency policies discussed in the joint statement, the *Interagency Guidance on High LTV Residential Real Estate Lending* and the *Uniform Retail Credit Classification and Account Management Policy*, do not apply to credit unions.

If you have any questions regarding the enclosed documents, please contact your district examiner, regional office, or state supervisory authority.

Sincerely,

/s/

JoAnn M. Johnson
Chairman

Enclosure