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HELOCs: Financing Options and Unique Regulatory Considerations

Consumer Finance Monthly Breakfast Briefing

Paul A. Jorissen
Partner
+1 212 506 2555
pjorissen@mayerbrown.com

Steven M. Kaplan
Partner
+1 202 263 3005
skaplan@mayerbrown.com

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What is a HELOC?

- A real estate secured revolving line of credit with a draw period and repayment term
- HELOC typically is documented with a loan agreement, instead of a promissory note, and a security instrument

How Does Federal Law Define a HELOC?

- CFPB Regulation Z, which implements the Federal Truth-in-Lending Act defines "open-end credit" as consumer credit extended by a creditor under a plan in which:
  - The creditor reasonably contemplates repeated transactions
  - The creditor may impose a finance charge from time to time on an outstanding unpaid balance
  - The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid

Satisfying TILA/Regulation Z Requirement

- **Existence of a Plan.** There must be a contractual arrangement between the creditor and the borrower that prescribes terms that govern all draws under a single credit plan. It is acceptable for some terms to be determined at a future date, as long as the contract describes how those terms will be determined. Advances generally should not be separately negotiated or underwritten.
- **Repeated Transactions.** The creditor must "*reasonably contemplate*" that the borrower will use the credit plan for repeated transactions. The credit plan accordingly must be "usable from time to time" and the creditor must "legitimately expect that there will be repeat business rather than a one-time credit extension." The inquiry focuses both on how the creditor has designed the plan and on whether borrowers actually engage in repeated transactions over time.

Why Do We Care About Satisfying TILA/Regulation Z Requirements?

- Closed-end home equity installment loans (HEILs) are subject to different regulatory requirements:
  - Ability-to-Repay (ATR) requirements
    - ATR for closed-end residential mortgage loans imposes underwriting requirements
    - Not like ATR for credit cards
  - Separate closed-end disclosure requirements

ATR Requirements

- The Regulation Z requirement that a mortgage creditor consider and verify the consumer’s ability to repay the loan (the “ATR Requirement”)
- ATR Requirement does not apply to a home equity line of credit subject to 12 C.F.R. § 1026.40
    - Regulation Z provides, however, that in connection with credit secured by a consumer’s dwelling that does not meet the definition of open-end credit, a creditor is prohibited from structuring the loan as an open-end plan to evade the ATR Requirement. The standards for determining whether a creditor has intentionally structured a loan as an open-end plan to evade the ATR Requirement are unclear.

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State Licensing

- Licenses may be required for the broker, lender, servicer, or purchaser
- HELOCs purchased during draw period
  - Lender licenses generally are required if make loans:
    - California - defining “mortgage lending” to include “advancing one’s own funds, or making a commitment to advance one’s own funds, to a loan applicant for a residential mortgage loan.”
    - Georgia - defining “makes a mortgage loan,” for purposes of the definition of a “mortgage lender,” to mean “to advance funds, offer to advance funds, or make a commitment to advance funds to an applicant for a mortgage loan.”

State Licensing

- Montana - defining a “mortgage lender” as “an entity that closes a residential mortgage loan, advances funds, offers to advance funds, commits to advancing funds for a mortgage loan applicant, or holds itself out as able to perform any of those functions.”
- North Carolina - defining “engaging in the mortgage business” to include “to make or fund, or offer to make or fund, or advance funds on residential mortgage loans ….”

Other Regulatory Considerations

- Negotiable Instruments/Holder-in-Due-Course
  - Are HELOC agreements negotiable instruments?
- Changes in Terms
  - Limited authority to change terms or charge fees that are not included in the HELOC agreement
- Anti-discrimination
  - ECOA and The Fair Housing Act

Other Regulatory Considerations

- UDAAP
- Terminating or Suspending HELOCs
  - Limited authority
    - Value of dwelling that secures HELOC declines significantly below appraised value
    - Reasonable belief that consumer will be unable to fulfill repayment obligation because of material change in consumer’s financial circumstances

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Purchase and Financing HELOC Product

- Acquisition before or after expiration of draw period
- Can funding obligation be assumed by buyer and is seller/originator released?
- What if funding obligation is breached?
- Perfection in HELOC and Security Instrument
- Custodianship/Recent Developments including Blockchain
- Structures for securitization
    - REMIC and funding via REMIC residual interest (subordinated/pari passu/senior)
    - <125% LTV calculated by subtracting first lien from value at origination on totally drawn balance
    - Debt for Tax and LTV limits
    - Risk Retention

Questions?

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