Other Real Estate and Off-Balance Sheet Exposures

1. What is the risk weight under the standardized approach for the on-balance sheet portion of a reverse mortgage?

Reverse mortgages receive the same risk weight treatment as traditional residential mortgages. A 50 percent risk-weight category applies if a reverse mortgage is (1) secured by a property that is either owner-occupied or rented; (2) made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the market value of the property at origination of the mortgage; (3) not 90 days or more past due or in nonaccrual status; and (4) not restructured or modified. A banking organization risk weights a reverse mortgage at 100 percent if the mortgage fails to meet any of the qualifying criteria for a 50 percent risk weight (see section 32(g) of the regulatory capital rule). Any portion of a reverse mortgage exposure that is *conditionally* guaranteed by the U.S. government (for example, Federal Housing Administration (FHA) guarantees) receives a 20 percent risk weight as set forth in section 32(a)(1)(ii) of the regulatory capital rule.

2. For purposes of a reverse mortgage, what is the treatment for the off-balance sheet component of the mortgage?

For available funds committed but not disbursed under the terms of the reverse mortgage contract, a banking organization should apply a credit conversion factor (CCF) of 50 percent to the undisbursed available commitment amount to calculate the exposure amount, given that such commitments are generally in effect for a period greater than one year (see section 33(b)(3) of the regulatory capital rule). The exposure amount would then receive a risk weight consistent with the risk weight treatment for residential mortgages (described above).

3. If a banking organization has a multipurpose facility that could include both financial and performance standby letters of credit, can the banking organization apply the lower of the two applicable CCFs (that is, 50 percent)?

Yes. A banking organization may apply the lower of the two applicable CCFs set forth in section 33 of the regulatory capital rule for commitments to extend letters of credit in the form of a financial or a performance standby letter of credit (that is, 50 percent).

4. Under other multipurpose facilities, a banking organization makes a commitment that could be drawn either as a letter of credit, a revolving loan, or a term loan. What is the correct CCF?

A banking organization may apply the lower of the two applicable CCFs set forth in section 33 of the regulatory capital rule for loan commitments (that is, 20 percent for short-term and 50 percent for long-term commitments) even though such exposures could be drawn as a letter of credit or a term or revolving loan.

5. In order for a residential mortgage to comply with prudent underwriting standards, can private mortgage insurance (PMI) continue to be relied upon for purposes of computing LTV ratios?

Yes. LTV ratios can account for PMI in determining whether a loan is made in accordance with prudent underwriting standards for purposes of section 32(g)(1)(ii) of the regulatory capital rule.

6. May a home equity line of credit (HELOC) be considered unconditionally cancellable?

Yes. A HELOC may be considered unconditionally cancellable to the extent it meets certain requirements. The regulatory capital rule defines unconditionally cancellable in section 2 to mean “a commitment for which a banking organization may, at any time, with or without cause, refuse to extend credit (to the extent permitted under applicable law).” In the case of a residential mortgage exposure that is a line of credit, a banking organization can unconditionally cancel the commitment if, at its option, it may prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by applicable law and the regulations issued pursuant to those laws. This treatment is effectively identical to that under the general risk-based capital rules.

7. What is the proper capital treatment for FHA Title I loans?

FHA Title I loans are secured by junior liens and are insured by the FHA at either a portfolio level or on an individual loan basis. The type of insurance provided by the FHA depends on the type, characteristics, and origination date of the loan.

FHA Title I loans that are insured on an individual loan basis should receive a 20 percent risk weight for the portion of the loan that is conditionally guaranteed by FHA, typically 90 percent of the outstanding loan balance, as set forth in section 32(a)(1)(ii) of the regulatory capital rule. The remaining, uninsured portion of the loan should be treated as a junior lien residential mortgage exposure for purposes of section 32(g)(2) of the regulatory capital rule.

FHA Title I loans that have portfolio insurance are considered to be securitization exposures because only a portion of the portfolio is covered by insurance and should be risk weighted according to the applicable securitization framework, as set forth in section 41(b) of the regulatory capital rule. Banking organizations also have the option to hold regulatory capital against the underlying exposures as if they are not a tranched guarantee. If this option is selected, these exposures should be treated as junior lien residential mortgage exposures.

8. For purposes of the regulatory capital rule’s definition of a statutory multifamily loan, can a multifamily mortgage receive a 50 percent risk weight during an interest-only period when no principal is due to be paid?

Generally, statutory multifamily loans receive a 100 percent risk weight in the first year after origination. If the loan meets all the criteria in the statutory multifamily loan definition set forth in section 2 of the regulatory capital rule, including the timely payment of principal and interest in accordance with the terms of the loan for at least one year and the debt service coverage ratio criteria, the loan will receive a 50 percent risk weight in year two, as set forth in section 32(i) of the regulatory capital rule. For statutory multifamily mortgages with an interest-only period, there are no principal payments due during this period. Therefore, as long as the interest payments are made on a timely basis in accordance with the terms of the loan during year one, the requirement for timely payment is effectively met and the multifamily loan would be eligible to receive a 50 percent risk weight beginning in year two. In addition, the debt service coverage ratio should be calculated using the amortizing payment (principal and interest) that will occur under the terms of the loan. In the case of an adjustable loan, the amortizing payment is based on the fully indexed rate.

An interest-only loan that does not meet the other criteria in the definition of a statutory multifamily loan would generally continue to receive a 100 percent risk weight.

9. For a residential mortgage loan that is not in default, and otherwise meets all the lending requirements for a 50 percent risk weight, what would be the appropriate risk weight for this loan after the banking organization lowers the interest rate for the sole purpose of keeping the borrower as a customer?

Under section 32(g) of the regulatory capital rule, a residential mortgage exposure may be assigned to the 50 percent risk-weight category only if it is not restructured or modified. Lowering the interest rate without any additional underwriting or documentation would constitute a loan modification and would subject the mortgage to a 100 percent risk weight. To continue receiving the preferential 50 percent risk weight, the banking organization would need to perform additional underwriting on the loan to the extent required for the banking organization to ensure that the credit quality of the borrower has not deteriorated. Moreover, in cases where the interest rate change is to prevent any type of payment increase or other change in terms (for example, from the end of a temporary fixed rate to a scheduled floating rate, from interest-only to amortizing payments, or to address an upcoming balloon payment), then the banking organization would need to fully re-underwrite the loan to maintain the 50 percent risk weight.