HOME EQUITY LENDING
Core Analysis Procedures

Examiners are to consider these procedures but are not expected to perform every procedure at every institution. Examiners should complete only the procedures relevant for the institution's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures not included below. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

References

- *Interagency Guidelines Establishing Standards for Safety and Soundness (FRB: 12 CFR 208, Appendix D-1; FDIC: 12 CFR 364, Appendix A)*
- *Interagency Guidelines for Real Estate Lending Policies (FRB: 12 CFR Part 208, Appendix C; FDIC: 12 CFR Part 365, Appendix A)*
- *Appraisal regulations (FRB: 12 CFR 225.61-67; FDIC: 12 CFR Part 323)*
- *Interagency Appraisal and Valuation Guidelines (FRB: SR 10-16; FDIC: FIL-82-2010)*
- *Frequently Asked Questions on the Appraisal Regulations and the Interagency Appraisal and Evaluation Guidelines (FRB: SR 18-9; FDIC: FIL-62-2018)*
- *Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions (FRB: SR 16-5; FDIC: FIL-16-2016)*
- *Uniform Retail Credit Classification and Account Management Policy (FRB: SR 00-8; FDIC: FIL 40-2000)*
- *Home Equity Lending Credit Risk Management Guidance. (FRB: SR 05-11; FDIC: FIL-45-2005)*
- *Interagency Guidance: Guidance on Nontraditional Mortgage Product Risks, and Addendum to Credit Risk Management Guidance for Home Equity Lending (FRB: SR 06-15; FDIC: FIL 89-2006)*
- *Home Equity Lines of Credit Consumer Protection and Risk Management Considerations when Changing Credit Limits and Suggested Best Practices (FDIC: FIL-58-2008)*
- *2012 Interagency Guidance on Allowance Estimation Practices for Junior Lien Loans and Lines of Credit (FRB: SR 12-3; FDIC: FIL-4-2012)*[1]
- *Home Equity Lines of Credit (HELOC) Nearing Their End of Draw Period (FRB: SR 14-5; FDIC: FIL-33-2014)*
- *Interagency Guidance on High LTV Residential Real Estate Lending (FRB: SR 99-26: FRIC: FIL-94-99)*

Findings and Conclusions

Document findings and conclusions here, and include a summary of these findings and conclusions in the appropriate Primary or Supplemental modules.

Preliminary Review

1. Review documents that may identify issues relating to home equity lending, such as:

- **Prior examination reports and workpapers**
- **Examination planning memoranda and file correspondence**

[1] **Generally not applicable to institutions that have adopted the Current Expected Credit Loss model.**

• **Loan review reports** • **Internal and external audit reports** • **Loan committee minutes** • **Documentation of action taken by management to correct prior deficiencies**
2. Determine the extent to which management is, or plans to be, engaged in home equity lending programs (e.g., closed-end home equity loans (HEL) or open-end home equity lines of credit (HELOCs)), and consider the types of products offered, target markets, and concentration levels relative to capital.
3. Determine whether management is, or plans to be, engaged in subprime home equity lending.[2]
4. Determine whether management uses third-party loan originators (i.e., brokers or correspondents).
5. Determine whether management uses pool insurance to mitigate the risk of high loan-to-value (HLTV) loans.
6. Determine whether management issues HELOC mortgage-backed securities.[3]
7. Determine whether management uses automated valuation models (AVMs), tax assessed values, or other indexed values to support collateral valuations in the appraisal or evaluation process.
Policy Considerations
8. Determine whether policies and procedures are commensurate with the volume and nature of the home equity lending activities. Effective policies generally address: • **Portfolio objectives and limits, along with monitoring procedures for key portfolio segments**

2 If subprime lending exists, or is planned, review the Subprime Lending module in conjunction with this module.

3 Refer to the Securitization Examination Documentation module, as needed.

- **Underwriting standards that include relevant risk factors[4] for both bank and third party originations**
- **Loan-to-value (LTV) ratios and guidelines for when mortgage insurance or additional collateral is required**
- **Loan administration procedures, such as documentation, disbursement, collateral inspection, collections, and loan review (including lien recording and verification of priority liens)**
- **Real estate appraisal and evaluation programs consistent with appraisal regulations**
- **Account management practices that identify higher risk accounts and adverse changes in account risk profiles to enable management to implement timely preventive action**
- **Procedures for managing problem loan workouts and loss mitigation strategies**
- **Guidance for risk ratings and nonaccrual reporting, including instances when a borrower is delinquent on a first mortgage**
- **Standards for renewing, extending, or rewriting loans that are approaching end-of-draw periods**

9. Determine whether collateral valuation policies and procedures are consistent with the appraisal regulations and include criteria for determining an appropriate valuation methodology, such as appraisals, valuations, or automated valuation models.

10. Assess the frequency with which the board reviews and approves real estate lending policies.

Administration

11. Determine whether management has an effective review and approval process for new product offerings, product changes, and marketing initiatives.

12. Determine whether management effectively monitors residential real estate market conditions in the trade area, including economic trends that influence home equity lending.

13. Evaluate management's efforts to mitigate increased portfolio risks in periods of economic downturns, declining markets, and declining home values.

[4] Underwriting standards and account administration practices should be consistent with consumer laws and regulations. If significant changes in underwriting or product type are noted, coordinate with a Compliance review examiner, as needed.

14. Determine whether management monitors loans in excess of supervisory LTV limits and reports such loans to the board at least quarterly.

15. Determine whether lines that are continually at or near their maximum usage are monitored, reported, and reviewed for collectability.

16. Determine whether line overages are permitted per policy and contractual agreement. If so, determine whether the overages are:

- **Within established guidelines**
- **Monitored and approved**
- **Required to be repaid in a timely manner**

17. Determine whether management has procedures in place to identify when payments are made by additional draws on the line or other lines of credit within the bank.

18. Determine whether management has a process for analyzing adverse events that could increase risk to the home equity portfolio. If so, evaluate the methodology and results, as well as any risk mitigation strategies developed because of findings.[5]

19. For large portfolios and portfolios with high-risk characteristics, consider whether management:

- **Periodically refreshes credit-risk scores on all customers**
- **Uses behavioral scoring and analysis of individual borrower characteristics to identify potential problem accounts**
- **Periodically assesses utilization rates**
- **Periodically assesses payment patterns, such as borrowers who make only minimum payments over a period of time or those who rely on the credit line to keep payments current**
- **Monitors home values by geographic area**
- **Obtains updated information on collateral values when market factors indicate potential, material declines in home values, or when payment performance deteriorates and greater reliance is placed on the collateral**
- **Updates and evaluates the combined LTVs when collateral values have deteriorated, including both junior and senior liens**
- **Tracks the status of senior liens**

[5] **Management's procedures to reduce or freeze HELOC availability may have consumer protection implications. If concerns are noted, coordinate with a Compliance review examiner.**

20. Determine whether management has processes to identify and monitor concentration risks, such as analyzing the portfolio by segments, such as product type, credit risk scores, debt-to-income (DTI) levels, combined LTV (CLTV), property type, and geographic area.
21. Determine whether annual credit reviews of HELOC accounts are conducted. If so: • **Determine whether management uses the reviews to decide whether to continue the accounts based on the borrower's current financial condition** • **Analyze exposure to accounts nearing the end-of-draw periods**
22. Determine whether AVMs are used to support evaluations or appraisals. If so, determine whether management: • **Periodically validates the models to mitigate potential valuation uncertainty in the model** • **Documents the valuation's analysis, assumptions, and conclusions** • **Back-tests a representative sample of evaluations and appraisals supporting loans outstanding** • **Evaluates the reasonableness and adequacy of its procedures for validating AVMs**
23. Determine whether management relaxes appraisal and evaluation requirements to enhance earnings or grow the portfolio.
24. Determine whether credit analysis and the allowance for credit losses (ACL)[6] or allowance for loan and lease losses (ALLL), as applicable, include sufficient information for management to assess risks within the junior lien portfolio.[7] Areas to consider include: • **Appropriate segmentation[8]** • **Plans for maturing HELOCs[9]**

[6] **The ACL for loans and leases is the term used for those banks that adopted ASU 2016-13, replacing the ALLL used under the incurred loss methodology.**

[7] **Coordinate with examiners conducting the general ACL or ALLL review.**

[8] **Inadequate segmentation results in an ACL or ALLL established for the entire junior lien portfolio that is lower than what the ACL or ALLL would be if higher risk loans were adequately segregated for evaluation.**

[9] **HELOCs that are approaching maturity may be renewed at higher interest rates, convert to amortizing loans, or have balloon payments due.**

- **Delinquency and modification status of senior liens[10]**
- **The frequency that the institution refreshes relevant credit quality indicators in relation to economic and housing market conditions**
- **The integration of appraisal and evaluation practices into the estimation of risk and the level of the allowance for individual credits and the portfolio as a whole**

Underwriting

25. Determine whether underwriting guidelines address items such as the following:

- **Ability to repay, including:**
  - **Analysis of global cash flows**
  - **Ability to amortize a fully drawn line of credit over a reasonable, fixed loan term**
  - **Ability to make interest payments at maximum contractual rates**
  - **Ability to appropriately service existing prior liens**
- **Credit score**
- **Credit history**
- **Loan size**
- **Collateral valuation, including valuation methodology**
- **Lien position**
- **Property type and location**

26. If management uses third-party originators, determine whether:

- **Management performs comprehensive due diligence on third-party originators prior to entering into relationships and on an ongoing basis**
- **Management delegates the underwriting function to the broker or correspondent**
- **Internal controls for delegated underwriting are adequate**
- **Management appropriately oversees critical loan processing activities, such as verifying the identity, income, and employment of borrowers, and validating the independence of the appraisal and evaluation function**
- **Appropriate controls exist to ensure third-party originators are:**
  - **Appropriately managed**
  - **Financially sound**
  - **Adhering to applicable consumer protection laws and regulations**
  - **Providing mortgages that meet the bank's underwriting guidelines**
- **A quality-control function exists that closely monitors the risk level of loans obtained through third-party underwriters**
- **Appropriate controls exist to verify third parties are not generating incomplete or fraudulent mortgage applications or receiving compensation inconsistent with contract terms**

[10] When a bank does not own or service associated senior lien loans, management generally uses reasonably available tools to determine the payment status of the senior lien loans. Such tools may include obtaining credit reports or data from third parties.

Documentation

27. Review loan files for the maintenance of appropriate documentation. Determine whether the following loan documents are on file:

- **Verification of borrower's identity**
- **Application**
- **Credit report**
- **Mortgage (or deed of trust)**
- **Note**
- **Attorney's opinion or title insurance**
- **Appraisal or collateral evaluation**
- **Evidence of appropriate insurance (e.g., property, liability, flood)**
- **Commitment letter (the final signed version)**
- **Settlement sheet (Closing Disclosure)**
- **Evidence of appropriate approvals**

28. Determine whether credit files contain sufficient information regarding additional pledged collateral or credit enhancements.

29. Determine whether effective controls have been established for perfecting liens, collecting outstanding loan documents, maintaining insurance coverage (including flood insurance), and paying property taxes.

30. Determine whether an effective system has been established to identify, analyze, approve, and track policy and underwriting exceptions.

Management Information Systems (MIS)

31. Determine whether management periodically assesses its MIS for home equity lending in light of portfolio growth and changes in the bank's risk profile and appetite.

32. Determine whether MIS is sufficient to:

- **Allow for adequate segmentation of the home equity portfolio**
- **Accurately assess key risk characteristics**

• **Provide management with sufficient information to identify, measure, monitor, and control concentration levels and over-limit accounts**
33. If the bank has a material home equity portfolio, determine whether MIS data capture and output reports are sufficient for management to evaluate: • **Production and portfolio trends (e.g., by loan product, loan structure, originator channel, credit score, LTV, DTI, lien position, documentation type, and property type)** • **Delinquency and loss-distribution trends by products and originator, as well as credit score, LTV, and DTI** • **Vintage tracking** • **Performance of third-party originators** • **Market trends by property type and geographic areas** • **Exposure to accounts nearing their end of draw periods** • **The performance of accounts that had terms modified while open or at renewal**
Credit Analysis
34. Analyze the level and trend in delinquencies, charge-offs, recoveries, and other key ratios for home equity loans.
35. Analyze the level and trends in the volume of loan renewals and modifications.
36. Classify consumer loans as appropriate, considering payment performance, collateral protection, and other relevant factors. Discuss classifications with management.
End of Core Analysis.