

June 17, 2008

Maine Bureau of Financial Institutions  
Maine Bureau of Consumer Credit Protection  
Joint Advisory Ruling #116  
"Convenience" HELOC's

Dear:

You have sought guidance as to whether or not "convenience" home equity lines of credit (HELOCs) are "simultaneous second-lien loans" as described in the "Interagency Guidance on Nontraditional Mortgage Product Risks" issued September 29, 2006 (the "Interagency Guidance") and consequently fall within the definition of "subprime mortgage loan" in PL 2007 Chapter 273 and PL 2008 Chapter 471 ("Maine's Predatory Lending Law").

In your request, you draw to the Bureaus' attention to Joint Advisory Ruling #111, in which the Bureaus considered a request for guidance regarding the inclusion of HELOCs generally under the definition of "subprime mortgage loan" in 9-A M.R.S.A. §8-103(1-A)(BB), which section defines "subprime mortgage loan" as either a "nontraditional" mortgage or a "rate spread" home loan.

Joint Advisory Ruling #111 states that HELOCs should not be included in the definition of "subprime mortgage loan" under 9-A M.R.S.A. § 8-103(1-A)(BB), except to the extent a HELOC is a simultaneous second-lien loan as defined in the Interagency Guidance, or meets the criteria of a high-rate, high-fee mortgage under §8-103(1-A)(V). Subsequent to issuance of Advisory Ruling #111, the Legislature passed "An Act Relating to Mortgage Lending and Credit Availability." This Act further limited the loans included under the Interagency Guidance so that, not only do HELOCs have to be simultaneous second-lien loans in order to be treated as nontraditional mortgage products, they must also allow a borrower to defer repayment of principal or interest.

In your request, you point out that "convenience" HELOCs are not new to the market nor are they considered to be "nontraditional" or "exotic" mortgage loans. You state that creditors typically offer "convenience" HELOCs as part of a relationship package to their best, or "prime," customers, *i.e.*, those customers who qualify in accordance with appropriate underwriting standards. You state that these HELOCs are often approved and offered to these first mortgage loan customers automatically, to be used at their convenience and sole discretion at some later time but not as part of the initial purchase or refinance of a purchase loan, nor in lieu of a higher down payment. As stated in your request, these "convenience" HELOCs are closed on the same day as the first mortgage, but are never tied to the first mortgage by a draw on the line for a down payment. You have also indicated that at least some of the "convenience" HELOCs being offered may contain a principal or interest deferral attribute and that such a feature is common with "convenience" HELOCs. This type of "all-in-one" closing, you indicate, is efficient for both the creditor and the borrower, and provides exceptional service to the creditor's best customers.

As part of your request, you have provided the Bureaus with information from the Federal Reserve Bank of Boston's website, and testimony from Deputy Comptroller Kathryn Dick dated September 20, 2006, which you state support your assertion that the Federal agencies, when commenting upon simultaneous second-lien loans, mean only those loans that are tied to the first mortgage by a draw on the line for a down payment, or used as an alternative to paying private mortgage insurance.

In light of this information, you assert that the type of simultaneous second-lien loans that were intended to be covered by the Interagency Guidance are those that were closed at the same time as the first mortgage and used toward the down payment on the first mortgage or used to avoid private mortgage insurance. Such a conclusion, you state, comports with the basis for which the Federal agencies issued the Interagency Guidance, and is consistent with public policy and the purpose of Maine's Predatory Lending Law, which is to protect consumers from unfair lending practices.

### **Bureaus' Response**

With respect to the treatment of simultaneous second-lien loans, it is the Bureaus' view that the Interagency Guidance is primarily concerned with those simultaneous second-lien loans that significantly reduce owner equity and increase credit risk. When disbursement is made simultaneously with a first lien loan there is a greater likelihood of causing immediate hardship to the borrower. Loans that have this effect are often, though not exclusively, tied to the first-lien loan by a draw at closing, and used for a down payment or to avoid payment of private mortgage insurance. The Appendix to the Interagency Guidance supports this view wherein it defines simultaneous second-lien loans as "[a] lending arrangement where either a closed-end second-lien or home equity line of credit (HELOC) is originated simultaneously with the first lien mortgage loan, typically in lieu of a higher down payment." (Underline added.) The Interagency Guidance indicates that simultaneous-second lien HELOCs typically increase a borrower's exposure to higher interest rates and payment burdens.

The Bureaus recognize that, if reasonable equity levels exist and the "convenience" HELOC is not used toward the down payment or to avoid payment of private mortgage insurance, then these types of loans lack the negative qualities that the Interagency Guidance seeks to address. Demonstration that (a) the borrower has a reasonable equity level in the subject property, and (b) the purpose of the loan is not for a down payment on a first mortgage or to avoid payment of private mortgage insurance, sufficiently indicates that a loan is a prime mortgage loan and not a subprime mortgage loan. Equity is related to credit risk, as is the ability to finance or refinance property without a second loan. The Bureaus believe that a reasonable equity level exists with respect to a transaction involving a "convenience" HELOC when the combined loan-to-value ratio of both the first loan and the HELOC is 90% or less.

Given the diminished risk associated with "convenience" HELOCs, they should not be labeled as subprime mortgage loans. This view is consistent with policy objectives of Maine's Predatory Lending Law and reflects the reality that lenders and borrowers

could simply delay obtaining "convenience" HELOCs in order to avoid classification as simultaneous second-lien loans.

## **Conclusion**

As indicated in previous advisory rulings, HELOCs are not considered nontraditional mortgages under the Interagency Guidance unless they are simultaneous second lien loans and also defer payment of principal or interest. "Convenience" HELOCs are those HELOCs that are closed simultaneously with a first mortgage but are not used toward the down payment on the first mortgage or to avoid payment of private mortgage insurance. Because "convenience" HELOCs do not present the same opportunities for abuse as other "simultaneous second-lien loans," the Bureaus agree that even those "convenience" HELOCs that permit deferral of payment of principal or interest should not be treated as "simultaneous second-lien loans" under the Interagency Guidance and, therefore, will not be considered "subprime mortgage loans" under Maine's Predatory Lending Law.

A simultaneous second-lien HELOC shall be regarded as a "convenience" HELOC under the Interagency Guidance, if (1) the convenience HELOC is not drawn at closing (or at the end of any applicable rescission period) to satisfy the first mortgage lender's equity requirements for granting the first mortgage loan, or to avoid payment of private mortgage insurance; and (2) the combined loan to value ratio of the first residential mortgage loan and the line amount of the second lien "convenience" HELOC is 90% or less.

Finally, the Bureaus wish to point out that even if a "convenience" HELOC does not fall under the Interagency Guidance, it may still fall within the definition of "subprime mortgage loan" if the loan terms meet the threshold for high rate, high fee mortgages.

We hope this guidance is responsive to your request for our opinion on this matter.

Sincerely,

/s/ Lloyd P. LaFountain III  
Superintendent

Bureau of Financial Institutions

Sincerely,

/s/ William N. Lund  
Superintendent

Bureau of Consumer Credit  
Protection