



## COMPLIANCE CHALLENGES

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# HELOCs are Hot

By Kris Kully

**H**ousing economists tell us that while rising mortgage rates have put the brakes on the refinancing boom, the value of American homeowner equity is higher than ever. Under those conditions, many credit unions are focusing on home equity lines of credit (HELOCs) as a hot product to meet their members' financing needs. A few compliance reminders will keep your credit union from getting burned.

HELOCs are exempt from several federal regulations, including the restrictions on loan originator compensation and the requirement to determine a member's ability to repay. However, those exemptions apply only to true open-end credit, and not to closed-end credit in disguise. To constitute "open-end" credit under the Truth in Lending Act (TILA), a lender must extend credit under a plan in which the lender reasonably contemplates repeated transactions, and the credit must generally be made available to the extent the consumer repays outstanding balances. If a plan does not satisfy those conditions, a court or regulator may characterize

the transaction as closed-end credit, subject to separate disclosure and substantive requirements.

Accordingly, HELOCs must be offered in accordance with a contractual arrangement prescribing the terms under which the borrower may obtain draws under the plan. Individual advances generally must not be separately negotiated or underwritten. The plan must have a revolving period during which the borrower may use, repay, and reuse at least a certain



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amount of the credit.

To determine whether the lender "reasonably contemplates" repeated transactions, the following factors generally would be considered:

- whether the plan is designed so that borrowers are reasonably able to make repeated transactions;
- whether the lender has a procedure for handling repeated transactions;



- whether the relationship allows financing a variety of purchases (as opposed to, for example, allowing purchases only from one retailer);
- whether the lender has fully performed its obligations under the agreement after making a single extension of credit;
- whether borrowers under the plan do in fact use it to make repeated transactions over time. The regulations do not, however, set any specific parameters for those factors.

While HELOCs are exempt from certain federal requirements, they are

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nonetheless subject to several special restrictions. Importantly, a lender must not, by contract or otherwise, terminate a HELOC and demand repayment, except in the case of borrower fraud, material misrepresentation, or payment default; or if the borrower's action or inaction adversely affects the lender's security for the plan. In fact, the lender is generally prohibited from changing any term of an existing HELOC unless the borrower specifically agrees to it in writing at the time, the change is insignificant, or the change will unequivocally benefit the consumer. A lender also may change a term of an ex-

isting HELOC to the extent that the initial agreement allows the lender to prohibit additional draws or reduce the credit limit if and when the maximum annual percentage rate (APR) is reached, or the initial agreement provides that specified changes will occur if a specified event takes place. Further, a lender may prohibit additional extensions of credit or reduce the credit limit applicable to an agreement during any period in which the property value declines significantly below the appraised value; the lender reasonably believes that the borrower will be unable to pay because of a material change in the borrower's financial circumstances; the borrower is in default of any material obligation under the agreement; or in the case of certain government action.

A creditor must provide the borrower a notice of such changes in terms when the changed terms are among those required to be disclosed in account-opening disclosures, unless the change consists solely of a reduction of the finance or other charge. When required, the lender must provide the notice at least 15 days in advance (unless the change is made pursuant to written consumer consent, in which case the lender must just provide the notice before the change.)

Lenders face potential liability if they fail to comply with the requirements described above. TILA provides that a borrower may sue the lender and recover damages, attorney's fees, and costs, either through a private or a class action. A lender's regulator also may bring an enforcement action. ▲

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