



The Regulatory Focus

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Mitigate HELOC Portfolio Risks

Prior to the start of the financial crisis in 2007, an extended period of rising property values and increasing consumer incomes contributed to an environment in which home equity lines of credit (HELOCs) offered lenders what appeared to be a relatively low-risk investment that provided reasonable returns. HELOCs were also attractive as a source of liquidity to consumers with available equity in their homes. Most Ohio state-chartered community banks and savings institutions have some level of investment in HELOCs on the balance sheet.

Typical structures for these credit products include an interest-only draw period of up to 10 years followed by an amortized repayment period of up to another 10 years. HELOCs are usually secured by junior liens on residential real estate. In some cases, underwriting standards were liberal and controls over appraisal processes were lax.

During the financial crisis, rising delinquency rates and declining real estate values significantly altered the risk profile of HELOC products, and exposed HELOC lenders to unexpected losses. Although loss rates associated with HELOCs have been trending downward recently, they remain elevated. In addition, bank regulators and industry analysts are concerned that credit risk exposure in HELOC portfolios warrant close scrutiny by bank managers. Potential risks include:

- **Borrower payment shock.** Many HELOC borrowers have been performing during the interest-only draw period of their loan contracts. As HELOCs enter the required amortization period, borrowers may find it difficult to pay principal and interest. In addition, if market interest rates increase from the current low-rate environment, adjustable-rate HELOC payments would increase even more. There is concern that delinquency rates in HELOC portfolios will significantly increase in the near future.

Continued on page 2

In this issue:

Mitigate HELOC Portfolio Risks	1-2
Ensuring SAFE Act Compliance	3
Regulating Money Transmitters in Ohio	5
Contact Information	5

Ohio Bankers Day Conference 2014 is coming up soon!

See page 4 for more details

Special points of interest:

- Superintendent Charles Dolezal Comments
— Page 4

Mitigate HELOC Portfolio Risks continued...

- **Insufficient collateral values.** Even though residential property values appear to be recovering in some areas, collateral may be insufficient to protect junior lien holders in the event of borrower default.
- **Enforcement of collateral rights.** In cases where security property values provide adequate coverage of senior and junior liens, the enforcement of junior lien collateral rights may be expensive and time-consuming. This may be especially true in areas with foreclosure backlogs.
- **First lien holders.** In cases where HELOCs are secured by second liens behind first liens held by other lenders, the junior lien holders may not be aware of borrowers with deteriorating credit performance.

Community bank credit managers with significant HELOC holdings or heavy concentrations in relation to capital should be aware of the risk exposure in their portfolios and actively manage the risks. Risk mitigation considerations include:

- **Monitor first liens.** The borrower's payment performance on first lien credits may be an early indicator of potential problems for the HELOC. If the first lien holder is another institution, HELOC lenders should monitor credit reports.
- **Monitor line utilization.** Deteriorating credit performance and high line utilization may indicate pending problems for the HELOC.
- **Workout scenarios.** Early detection of deteriorating borrower capacity may permit development of a workout strategy, such as refinance or debt consolidation that benefits both the borrower and the lender. Keep in mind changing consumer protection regulations that may apply.
- **Enhance underwriting.** If not done already, strengthen HELOC underwriting standards and require analysis of the borrower's ability to service the debt during the amortization period. Also enhance appraisal/evaluation processes to ensure that they meet regulatory standards and provide accurate collateral values sufficient to protect both the first and junior lien holders.
- **Adequate loss provisions.** Federal banking agencies have issued guidance for portfolio analysis and segmentation to ensure that the allowance for loan and lease losses (ALLL) adequately reflect the risk in the HELOC portfolio. Refer to FDIC Financial Institutions Letter (FIL) 4-2012 or Federal Reserve Supervision and Regulation (SR) Letter 12-3, Interagency Supervisory Guidance on Allowance for Loan and Lease Losses Estimation Practices for Loans and Lines of Credit Secured by Junior Liens on 1-4 Family Residential Properties.
- **Board reporting.** As always, keep the board of directors fully informed of the institution's credit risk status and management's risk mitigation strategies.

Directors and executives of institutions with material HELOC portfolios or other junior lien loan products should recognize the risks that may result in deteriorating performance and ensure that processes are in place to quantify those risks. Early identification of emerging problems may give credit managers the opportunity to implement timely workout strategies that minimize potential losses. Contact your Ohio Division of Financial Institutions Regional Supervisor for more detailed discussion.

Ensuring SAFE Act Compliance

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) required the establishment of a nationwide licensing and registration system for residential mortgage loan originators (MLOs). The resulting Nationwide Mortgage Licensing System & Registry (NMLS), administered by the Conference of State Bank Supervisors, is the registration system for state licensed, non-depository companies and individuals, as well as for depository institutions and their employees.

The Dodd-Frank Wall Street Reform and Consumer Protection Act placed the rule-making authority for the SAFE Act under the auspices of the Consumer Financial Protection Bureau (CFPB). Governing regulations are set forth in 12 CFR Part 1007, now called Regulation G. Most depository institutions were well aware of the registration requirements of the SAFE Act and successfully registered their MLOs with the NMLS when it began operation in 2011. In addition to establishing the registration requirements and definitions, however, Regulation G also requires depository institutions to maintain policies, procedures, and monitoring systems to ensure compliance with the SAFE Act. These policies and procedures “must be appropriate to the nature, size, complexity, and scope of the mortgage lending activities” of the depository institution, but at a minimum must:

- Establish a process for identifying which employees must be registered;
- Require that all employees who are MLOs be informed of the registration requirements of the SAFE Act and Regulation G and be instructed on how to comply;
- Establish procedures to comply with Regulation G’s unique identifier requirements;
- Establish reasonable procedures for confirming the adequacy and accuracy of MLO employee registrations, including updates and renewals, by comparisons with its own records;
- Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;
- Provide for annual independent testing for compliance with Regulation G;
- Provide for appropriate action if an employee fails to comply with the registration requirements of Regulation G or the institution’s related policies and procedures, including prohibiting such employees from acting as MLOs or other appropriate disciplinary actions;
- Establish a process for reviewing employee criminal history background reports received pursuant to the regulation, taking appropriate action consistent with applicable federal law and implementing regulations with respect to the reports, and maintaining records of the reports and actions taken with respect to applicable employees; and
- Establish procedures designed to ensure that any third party with which the institution has arrangements related to mortgage loan origination has policies and procedures to comply with the SAFE Act and Regulation G, including appropriate licensing and/or registration of individuals acting as MLOs.

Federal banking regulatory agencies (CFPB, Federal Reserve Board, and FDIC) have developed and are implementing examination procedures to determine whether depository institutions have adopted written policies and procedures to ensure SAFE Act compliance, including the annual independent testing requirement. Please be aware of these requirements and ensure that your institution has established the appropriate processes to ensure compliance with the SAFE Act and Regulation G.

More information can be found at the following websites:

CFPB: <http://www.consumerfinance.gov/>

NMLS: <http://mortgage.nationwidelicencingsystem.org/Pages/default.aspx>

From the Superintendent...

One important goal of the Division of Financial Institutions (DFI) is to be accessible to you as your regulator. Through various outreach initiatives including this newsletter, we want to maintain open communications with state-chartered institutions and to bring you timely information on current hot topics. Along the way, we hope to provide opportunities for you to also voice your concerns and provide feedback.

This year we are pleased that several initiatives are in the works to make this happen. On June 24 we will be hosting our annual Ohio Bankers' Day program at the Hilton Columbus at Easton. Similar to last year, the event will include a morning general session and breakout sessions, a luncheon speaker and a second round of breakout sessions in the afternoon. During May, information technology (IT) roundtables were held in Cleveland and Cincinnati to review best risk management practices and the latest IT hot topics. Another is scheduled for June 25 in Reynoldsburg.

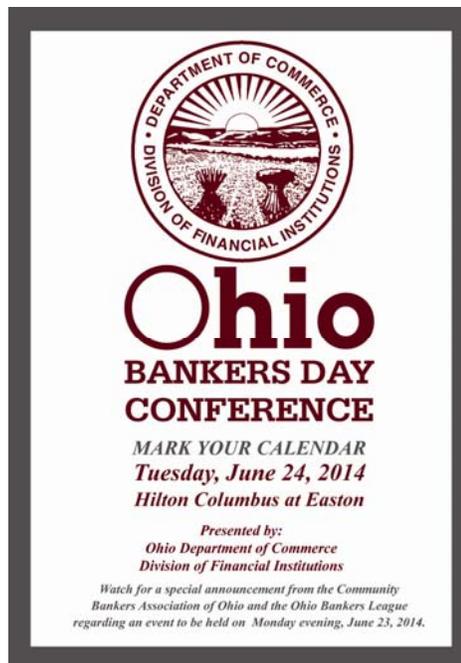
Details are also being worked out for a Fall Directors' training seminar to be held in the Columbus area. This one-day session will give your Directors insight into board room best practices, CAMELS from a regulator's perspective, and regulatory hot topics. And, of course, later this Fall we will be holding our annual regional roundtables as we have in the past.

And finally, in order to improve our processes and gain constructive feedback from you, a post-examination survey is being developed that will provide an opportunity to comment on the Division's examination process, the content and quality of the Division's Report of Examination, and the conduct of DFI examination staff.

We look forward to seeing you, your Directors, and your staff at these upcoming events. If you have any questions or wish to discuss any issues, please feel free to contact me at Charles.Dolezal@com.ohio.gov or (614) 644-7501.



Superintendent
Charles Dolezal



It's time for the Ohio Bankers Day Conference 2014!

Tuesday, June 24, 2014 at the Hilton Columbus at Easton.

For the registration packet, click here:

<http://www.com.ohio.gov/social/OhioBankersDay2014registrationagendafinal.pdf>



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Regulating Money Transmitters in Ohio

Money transmitters in Ohio are licensed and supervised by the Division of Financial Institutions with 66 licensed money transmitters as of March 31, 2014. The Ohio Money Transmitter Act (Chapter 1315) is based on the laws for Ohio banks and incorporates safety and soundness concepts. Standards for capital, earnings and liquidity provide safety and soundness measures for licensing and on-going supervision. Regulatory compliance (i.e. Bank Secrecy Act) and overall management performance are also considered in the licensing and examination processes.

Licensing requires applicants to demonstrate capital levels, viability of a business plan, management resources and experience, and the adequacy of policies and procedures to comply with all state and federal laws and regulations. For example, the management team should include an experienced financial officer who is responsible for the accounting function. Most importantly, an applicant must have a qualified compliance officer and a comprehensive Anti-Money Laundering Program that comply with the Bank Secrecy Act, USA PATRIOT Act and Office of Foreign Asset Control regulations.

Money transmitter examinations focus on reviews of financial operations, management policies, procedures and practices, as well as compliance with laws and regulations. Examinations start off-site with examiners reviewing policies and transaction data. Then examiners visit authorized delegate or agent locations prior to going on-site at the licensee's headquarters to determine compliance with laws, regulations and company policies at the Ohio locations. As many of Ohio's licensees are licensed in multiple states, Division examiners are often participating in coordinated multi-state examinations of the licensees.