

FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET, SAN FRANCISCO, CALIFORNIA

June 8, 2005

**BANKING SUPERVISION AND REGULATION:
CREDIT RISK MANAGEMENT
GUIDANCE FOR HOME EQUITY LENDING**

To State Member Banks, Bank
Holding Companies, U.S. Branches
and Agencies of Foreign Banks,
and Others Concerned,
in the Twelfth Federal Reserve District

Agencies Issue Credit Risk Management Guidance for Home Equity Lending (SR 05-11)

The federal bank, thrift, and credit union regulatory agencies have issued guidance that promotes sound risk management practices for home equity lines of credit and loans. The agencies have found that in some cases credit risk management practices for home equity lending have not kept pace with the product's rapid growth and eased underwriting standards.

The rise in home values, coupled with low interest rates and favorable tax treatment, have made home equity lines of credit and loans attractive to consumers. To date, delinquency and loss rates for home equity portfolios have been low, due at least in part to the modest repayment requirements and relaxed structures of this lending. However, the agencies have identified risk factors that, along with vulnerability to interest rate increases, have attracted scrutiny, including the following:

- Interest-only features that require no amortization of principal for a protracted period
- Limited or no documentation of a borrower's assets, employment, and income
- Higher loan-to-value (LTV) and debt-to-income ratios
- Lower credit risk scores for underwriting home equity loans
- Greater use of automated valuation models and other collateral evaluation tools for the development of appraisals and evaluations
- An increased number of transactions generated through a loan broker or other third party

The agencies note that active portfolio management is especially important for financial institutions that project or have already experienced significant growth or concentrations in higher risk products, such as high LTV, limited documentation and no documentation interest-only, and third-party generated loans.

Like most other lending activity, home equity lending can be conducted in a safe and sound manner with appropriate risk management systems. This guidance outlines the agencies' expectations for sound underwriting standards and effective credit risk management practices for a financial institution's home equity lending activity.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's Internet site, at <http://www.frbsf.org/banking/letters>.

For additional information about the guidance please contact our Banking Supervision and Regulation Department at (801) 322-7964.

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Attachment: *Interagency Credit Risk Management Guidance for Home Equity Lending*