

INSTRUCTIONS – R.E.A.P.[®] REAL-ESTATE EQUITY ADVANCE PLAN LOAN AGREEMENT & FEDERAL TRUTH-IN LENDING DISCLOSURE

[Instructions (Rev. 5/05)]

Consumer WCUL #82085 (Rev. 3/05)

Non-Consumer WCUL #82087(Rev. 3/05)

Note: These instructions do not provide complete guidance on home equity line documentation, compliance, and program requirements. See *ii Release B064* and Reg. Z § 226.5b for more information.

As the loan agreement, the terms of these documents are the legal requirements the credit union and borrower must adhere to. It is important for credit union staff to read and become familiar with the terms of the agreement.

Many of the terms in a HELOC are mandated by the law: Truth in Lending, Wisconsin Consumer Act, Wis. Stats. §§ 138.052 and 138.056, Marital Property Act, and the Equal Credit Opportunity Act.

Consumer vs. Non-Consumer Forms. The Consumer versions of the R.E.A.P. forms are designed for home equity lines of credit (HELOCs) subject to the Wisconsin Consumer Act (WCA). The WCA applies to HELOCs when they are:

- granted to individuals,
- for a personal, family, or household purpose,
- unless secured by a first lien real estate mortgage or equivalent security interest.

The Non-Consumer versions of the R.E.A.P. forms are designed for HELOCs subject to Wis. Stats. §§ 138.052 and 138.056, as well as Wis. Stats. Ch. 428. These sections generally apply to credit:

- granted to individuals,
- for a personal, family, or household purpose,
- secured by a first lien real estate mortgage or equivalent security interest.

A second mortgage security interest is equivalent to a first lien mortgage when there is no *other* lender in position ahead of the credit union's HELOC. Thus, if the credit union grants a HELOC, and the first mortgage is also held by the credit union, the HELOC is equivalent to a first lien mortgage. Such a loan would be documented on the Non-Consumer R.E.A.P. forms, and is subject to Wis. Stats. § 138.052 instead of the Wisconsin Consumer Act.

The Wisconsin Consumer Act has an exemption for loans with an amount financed exceeding \$25,000. This exemption should generally be disregarded in regard to HELOCs and other open-end credit plans. The Administrator of the Wisconsin Consumer Act takes the view that merely approving a line of credit exceeding \$25,000 does not ensure that the line of credit ever actually will exceed \$25,000, so does not qualify for the exemption.

Heading

Insert the REAP loan account number, and then fill in the Maximum Principal Loan Balance, with the credit limit approved for the borrower.

Insert the credit union name and address, using its full legal name since this is a legal document. Insert the legal name of each borrower, and their address.

Section [1] Establishment of Plan

In this section, the borrower requests the line of credit and agrees to the maximum Principal Loan Balance.



Section [2] Borrower's Promise to Pay

In this section, the borrower agrees to pay all amounts loaned, as well as agreed finance charges and additional charges as specified later in the agreement. The borrower also agrees to make the payments as specified later.

Section [3] Interest Rate

This section discloses the initial interest rate under the plan. It also explains how the Principal Loan Balance (upon which interest is charged) is computed. The credit union must be certain that its data processing system uses this balance computation method.

Insert the daily periodic rate that the credit union's data processing system will initially charge on the plan, and the corresponding annual percentage rate (APR). If the plan uses a variable rate, that is irrelevant in this section. If the HELOC starts with a discounted rate, use the discounted rate, not the rate that results from adding the margin to the current index value.

The disclosed annual percentage rate should be based only on the interest rate, and is not affected here by other finance charges.

Please note that the space for the daily periodic rate has a percent sign preprinted. Thus, the daily periodic rate that is inserted should have two fewer zeros immediately to the right of the decimal point than is correct for displaying the same daily periodic rate without a percent sign.

Section [4] Variable Rate

This section sets forth whether the interest rate is fixed or variable. Check the boxes in (a) or (b) as applicable, never both.

- (a) Check the box if the plan is based on a fixed interest rate. Fixed rates are rarely used on a HELOC. An example of how one might be structured is to use a fixed rate, structure the draw period for one year, and require a balloon payment to pay off the entire balance at the end of the one year draw period. The lender could invite the member to rewrite the plan at the end of the draw period for another year at the then prevailing rate.
- (b) Check the first box if the plan uses a *variable interest rate*. The rest of (b) is the variable rate clause.

Change dates

The next space to be completed specifies the first date that the credit union will adjust the interest rate. Normally, this will be the next change date under the terms of the credit union's plan, but the credit union may have a later first rate adjustment. Insert a specific date such as Dec. 1, 2005.

In the next spaces insert the description of when the interest rate will be adjusted throughout the remainder of the plan. This becomes the "change date" under the agreement. Examples include:

- ...and thereafter on the *first* day of each *week*....
- ...and thereafter on the *first* day of each *month*....
- ...and thereafter on the *first* day of each *calendar quarter*....
- ...and thereafter on the *first* day of each *June*....

Index value date

Choose the first or second indented check box in (b) to identify the variable rate index used under the credit union's HELOC plan. Reg. Z requires that a variable rate HELOC plan use an index rate that is (1) outside the control of the credit union, and (2) verifiable by the borrower.

The first indented check box in (b) offers a fill in the blank variable rate clause based on the highest prime rate published in *The Wall Street Journal* on a particular day. *The Wall Street Journal* is one of the most popular indices used for HELOCs. Use of this fill-in-the-blank clause reduces the risk of the credit union using a poorly worded clause that can cause compliance problems for the credit union.

Check the box and fill in the blank with language identifying what day's WSJ prime rate value will be used to adjust the HELOC rate. The index value day must be worded in a way that makes sense with the "change date" specified earlier.

For example, if the change date (on which the member's rate changes) is the *first day of each month*, then it may work well to state that the rate shall be "the highest prime rate published in *The Wall Street Journal* 'Money Rates' table on the 15th day of the prior month...."

Care must be taken that there is enough of a time lag between the day the index value date, on which the index value is drawn from *The Wall Street Journal* or other source, and the change date, when the credit union starts to charge the adjusted interest rate. There are two issues to watch for:

- First, will the credit union have enough time between the index value date and the change date obtain the rate and implement the change date, taking into account the illnesses, vacations, or unanticipated delays?
- Second, the credit union will the gap between the index value date and the change date be enough time to allow the credit union to mail variable rate adjustment notices meeting the timing requirements of applicable law. This becomes an issue here if the interest rate change will result in a change to the payment level on the plan. This will not happen if the credit union uses the preprinted payment clause in Section [7] of the REAP form. However, if an increase in periodic payments other than the final payment is required as a result of the rate change, then first lien mortgage or equivalent security interest lines under § 138.056 need the notice to be sent at least 30 days before the rate change takes effect.

Consider again our earlier example, in which the change date is the *first day of each month*, then it may work well to state that the rate shall be "the highest prime rate published in *The Wall Street Journal* 'Money Rates' table on the 15th day of the prior month...." This will always allow a 14 to 16 day lag period. This is sufficient to allow for vacations or unanticipated delays in implementing the new rate. Also, if the credit union uses the preprinted payment clause, the rate change will not result in an increase in the monthly payments.

However, if the credit union uses an interest-only payment clause in this example, payments will necessarily increase when the rate goes up. If the loan is secured by a first mortgage or equivalent lien, the credit union must send the rate change notice 30 days before the higher interest rate is applied to the plan. The clause in our example will not work. The credit union would be out of compliance. The same problem will exist with any other customized payment clauses that are tied to increases in the interest rate.

If the credit union checks the second indented check box in (b) to identify a different index, be sure it is an approved index under the Wisconsin Consumer Act and Wis. Stats. § 138.056. It also must be

(1) outside the control of the credit union, and (2) verifiable by the borrower. If the space provided is inadequate, you may add a notation to cross-reference Section [21] and add language in that space.

The second indented check box can also be used to cross-reference a Variable Interest Rate Addendum if the credit union wishes to use a completely different variable rate clause. Check the second indented box and insert the following:

The daily periodic rate and Annual Percentage Rate disclosed in [3] above is a variable rate subject to change under the terms of the Variable Interest Rate Addendum executed on the date of this Loan Agreement and incorporated herein by reference.

Be sure that any variable rate clause that the credit union devises complies with the Wisconsin Consumer Act, Wis. Stats. § 138.056, and Reg. Z § 226.5b and § 226.6 as applicable.

Margin, Current Index Value, Lifetime Cap & Floor

In the paragraph beginning with “(the ‘Index’),” insert the interest rate *margin* in the first blank. It is already labeled as percentage points, so no percent sign should be inserted.

In the next blank, insert the *current value* of the Index. Do not round off the figure at all; use the figure as reported in *The Wall Street Journal* or other source identified as the Index.

In the next sentence, insert the *lifetime rate cap* and, if desired, a *lifetime rate floor*.

A lifetime rate cap is required by Reg. Z. Wisconsin no longer has a usury law so a state chartered credit union may set the lifetime rate cap at any level it chooses. Federal credit unions are subject to an 18% usury limit, so must set the cap no higher.

A lifetime rate floor is not required. A recent interpretation by the Administrator of the Wisconsin Consumer Act holds that lifetime rate floors are not restricted by the WCA.

Rounding

Check the fourth box in (b) if the credit union will round off the interest rate to be applied to the loan. This is not usually done using the daily prime rate as that is already reported in half point intervals. However, if the credit union uses the fill-in-the-blank section to identify an index that is reported in hundredths or thousandths of a point, the credit union may want to round the rate. If so, check the box and insert language into the blank as shown in one of these examples:

- shall be rounded to the *nearest* percentage point.
- shall be rounded to the *nearest quarter* percentage point.
- shall be rounded to the *next higher ¼* percentage point.

Discounted Rate

Sometimes a credit union chooses to offer a discounted initial interest rate – one that is lower than the rate that would result from applying the plan’s margin to the current value as would normally be done.

If a borrower’s line starts with a discounted rate, check the fifth box in [4](b). Also insert the Daily Periodic Rate and Annual Percentage Rate that would have been imposed if there were no discount in effect.

Besides completing this discount section of the agreement, the credit union must be able to adapt its Reg. Z HELOC Application Disclosure and any advertisements that mention the rate to comply with special requirements for discounted plans.

See the HELOC Advertising Compliance Checklist (Exhibit C) and the Sample R.E.A.P. Reg. Z HELOC Application Disclosure (Exhibit E) in *ii Release B064* for guidance on those aspects.

Section [5] Finance Charges & Additional Charges to Establish the Plan

Use Section [5] to disclose charges that are imposed on the borrower to apply for or establish the plan, regardless of whether they are paid in cash or from an advance on the plan.

Use [5] (a) to list what Reg. Z classifies as prepaid finance charges. Examples of these could include points and an application fee that is not charged to all applicants. See Reg. Z § 226.4 and § 226.5(a) and the corresponding Commentary for further guidance on what are and are not finance charges. List the name and amount of the finance charge. Add an “e” after any figure that is an estimate.

Use [5] (b) to list what Reg. Z classifies as “other” charges, which include any charge other than a finance charge that may be imposed as part of the plan. Some common examples are listed, and blank lines are available for others. Add an “e” after any figure that is an estimate. See the Commentary to Reg. Z § 226.6(b) for additional examples of what are and are not “other charges.”

The name and amount of the fee must be given. In some case space is provided to identify the recipient of the fee. If there is an annual fee to maintain the plan, space is provided to identify when the fee will be imposed each year.

Section [6] Additional Charges That May Be Imposed During Term of Plan

Use [6] to list those finance and other charges that may be imposed during the plan, after it is established.

Preprinted lines are provided for cash advance fees or minimum finance charges. These are Reg. Z finance charges and must be reflected as finance charges on the credit union’s periodic statements when imposed. In addition to labeling them as finance charges, the credit union must correctly show the effect of these finance charges on the annual percentage rate. Consult your data processor and see Reg. Z § 226.14 and Commentary for guidance.

Spaces are also preprinted to impose charges for late fees and bounced checks presented to make payments on the plan. For Non-Consumer plans subject to Wis. Stats. § 138.052, a late fee may not be imposed unless the payment is not received within 15 days after the due date, and the dollar amount may not exceed 5% of the unpaid portion of the installment.

For Consumer and Non-Consumer Plans, the returned check charge may only be imposed once per check, not once per return. Also, it may be imposed only for returned checks, not ACH.

A blank space is provided to insert customized clauses for additional charges, but be sure to determine whether they are finance charges. If they are, you must state so, making the term “finance charge” more conspicuous than the other text, such as by using all capital letters for that term.

Section [7] Payments

This section includes the clause requiring minimum payments through the life of the plan.



Minimum Payment Amount

The preprinted option by the first check box provides for repayment terms that would apply throughout the life of the plan, including the draw period and the repayment period. Check the first check box and fill in a flat minimum monthly payment at (a). Then insert a dollar amount at (b) which the borrower is to pay for each \$100 of the outstanding balance. Be sure to insert figures in both (a) and (b) if this preprinted option is used.

You must also check a box to specify whether the amount specified in (b) is billed based on the Principal Loan Balance as of the date of the most recent advance or as of the close of the billing cycle. The “most recent advance” option will result in quicker repayment since the payment will not shrink each billing cycle.

It is important to test how long a loan will take to repay at the highest rates under the plan.

For example, assume the payment is set at \$2 per \$100 of outstanding balance, as of the most recent advance, and the maximum rate under a \$50,000 limit plan with a 10-year draw period is 18%. Let’s say a member draws to the limit just before the end of the draw period, and rates are at 18% and stay there.

How long will it take to pay off the \$50,000 balance if the member makes only the minimum payment?

The minimum payment would be \$1000. Of that payment, \$250 would be applied to the principal balance each month – assuming no other fees were incurred. It will take 200 months to pay off the \$50,000 balance. It will take 16 years and 8 months, after the 10-year draw period to pay off the balance. Of course, the member will almost certainly pay off the loan faster, because rates are unlikely to stay at 18% for a period of years. Still, we must appreciate the risk.

In a low interest rate environment, the loan balance would pay off much faster. If the interest rate in the example were at 6%, and remained there, the loan would be paid off in its 66th month – 5½ years after the end of the draw period.

Maybe your credit union should consider a balloon payment.

If the credit union wishes to use a monthly minimum payment level lower than \$1.90 per \$100 of outstanding balance, it may be advisable to require a balloon payment at the end of the draw period. The sample language below may be used, completed with the payment level desired during the draw period:

[X] *during the Draw Period: the greater of (a) \$_____ or (b) \$_____ for each \$100 (and fraction thereof) of the Principal Loan Balance as of the ☐ date of the most recent advance ☐ close of the billing cycle; and at the end of the Draw Period: the entire unpaid balance, including all unpaid Finance Charges.*

If the space provided is inadequate for a credit union’s customized payment clause, you may add a notation to cross-reference Section [21] and add language in that space.

If a balloon payment is used, the credit union must also strike the second sentence in Section [8], which says, *The length of the subsequent repayment period is indefinite: after the end of the Draw*

Period, the Borrower must continue to make at least the minimum payments as specified in [7] until the Borrower's Account is repaid in full.

If a balloon payment is used, the credit union must address that feature in drafting its Reg. Z HELOC Application Disclosure and any advertisements that refer to the payments.

What about Interest-Only Payments?

Some credit unions have explored offering HELOCS that call for interest-only payments during the draw period, and a balloon payment at the end of the draw period. Here are some observations and suggestions:

- In marketing for interest-only plans, be sure to include a footnote disclosing what the payments requirements are after the interest-only phase.
- Use this language only if adjusting payments at close of the billing cycle – which requires providing monthly periodic statements that will bill for the new amount that will result each month.
- Be sure to underwrite loans at highest possible payment level – highest rate, and highest balance. Borrowers must beware of payment shock
- With interest-only payments, the credit union will be unable to assess late fees or other fees during the draw period, because they would trigger negative amortization.
- During the draw period, be sure to charge no more interest than will be billed. If your daily periodic rate is $1/365$ of the APR, and if during most years your interest-only billing is on that basis, be sure that you don't bill the same daily periodic rate on each of the 366 days in a leap year.
- Ch. 138 non-consumer (first mortgage or equivalent lien) loans will require a rate change notice 30 days before a rate takes effect that will require a higher payment. Most credit unions will need to revise their variable rate clauses to build in a lag time of more than 30 days between the date of a change in the index value and the date it is applied to the member's loan. The traditional preprinted payment clause in REAP did not adjust based on rate changes so was not subject to this advance timing requirement for change notices. See Adjustment Notice Requirements for § 138.056 Variable Rate Real Estate Loans at the end of this document.

Language such as the following may serve as the interest-only/balloon payment clause:

[X] *(a) during the Draw Period: the total amount of unpaid Finance Charges as of the close of the billing cycle; and (b) at the end of the Draw Period: the entire unpaid balance, including all unpaid Finance Charges*

Since a balloon payment is used here, the credit union should also strike the second sentence in Section [8], which says, *The length of the subsequent repayment period is indefinite: after the end of the Draw Period, the Borrower must continue to make at least the minimum payments as specified in [7] until the Borrower's Account is repaid in full.*

Payment Due Date

The next paragraph requires the credit union to insert the due date for the borrower's payments. Insert the numbered date of the month. It also explains how payments are applied. The credit union must conform its system to the method described in this section of the REAP agreement.

Automatic Debit Authorization

Section [7] also includes language whereby the member may authorize the credit union to debit the member's share draft account for the minimum payment amount. Check the box and insert the member's share draft account number.

Section [8] Draw Period; Access Methods

Draw Period

The credit union's obligation to lend under a HELOC plan is not intended to last forever. Since the credit union cannot terminate the plan at its discretion, or make change significant terms unilaterally, the forms specify an end to the draw period, so payments can continue and the balance is eventually paid off.

Insert an anniversary number to designate the end of the draw period, such as *tenth* or *fifteenth*. Never leave the draw period blank.

If a balloon payment is used, the credit union must also strike the second sentence in Section [8], which says, *The length of the subsequent repayment period is indefinite: after the end of the Draw Period, the Borrower must continue to make at least the minimum payments as specified in [7] until the Borrower's Account is repaid in full.*

Methods of Access

Section [8] also outlines the methods of accessing the REAP plan. It automatically provides for advances to be available by completion of the Request for Advance form (#82035).

- The Request for Advance form may be completed in person and signed by the borrower.
- If a request is taken by telephone, or insecure electronic communication, the Request for Advance form may be completed by staff and a copy mailed to the member. However, the credit union is at risk if it pays to a third party based on an unsigned request. Instead the credit union should only allow deposit to the member's own account, or the mailing of a check made payable to the member.

If it has developed the capability, the credit union can also check a box to allow access by special share draft or credit card devices. Check the appropriate box, but only if the credit union has the appropriate policies, agreements, and data processing capabilities in place.

Share draft access requires use of the R.E.A.P. Share Draft Agreement card (82089) and R.E.A.P. Share Draft Account Rules (#82090). These forms call for use of an account that maintains a zero balance, until a share draft is presented. Then, an advance is paid to the R.E.A.P. share draft account to clear the check, and the balance goes back to zero. R.E.A.P. is not intended for use as overdraft protection on a regular share draft account.

A check box is provided in case the credit union develops credit card access to its R.E.A.P. plan. The League does not have policies, procedures, or special agreement language to implement such a program. To create credit card access, the card would be subject to the REAP agreement, embodying all of the Reg. Z restrictions, and not subject to a regular credit card agreement. Implementing this would be very difficult to achieve with many credit unions' data processing systems.

Section [8] spells out the limited grounds for suspending a Borrower's right to advances under the plan, and the procedures for the Borrower to request reinstatement of loan privileges. It also addresses prepayment rights under the plan.

Section [9] Termination

Section [9] addresses the limited grounds for the credit union to terminate the R.E.A.P. plan. Although Reg. Z would permit the credit union to accelerate all payments under the plan upon any of the three events, the Wisconsin Consumer Act prohibits acceleration until there is a default under the plan and the 15-day Notice of Right to Cure Default has expired.

Section [10] Transaction Limits

Section [10] provides options for the credit union to check off if it wishes to require a minimum balance to be maintained on the plan (very rare) or to set a minimum draw amount (very common). Another space is offered in case a credit union has a customized transaction limitation.

Any transaction limitation set forth in Section [10] must also be included in the Reg. Z HELOC Application Disclosure. The League's Sample R.E.A.P. Application Disclosures include clauses for Minimum Balance and Minimum Draw Requirements.

Section [11] Collateral

Section [11] specifies the collateral used for the plan. Insert the date of the mortgage and the street address of the property secured by the mortgage. This section includes a limited cross-collateral clause. It also disclaims the mortgage as collateral for amounts in excess of the Maximum Principal Loan Balance. This is to avoid securing advances in a situation that would trigger a right to rescind under Reg. Z. Finally, the mortgage is disclaimed as security during any period when the loan balance is \$1,000 or less on the Wisconsin Consumer Act version of the R.E.A.P. agreement, to avoid violating Wis. Stats. § 422.417(3).

Section [12] Insurance

This section discloses that credit insurance is not required, and discloses the cost of property insurance if purchased from the credit union (very rare).

Section [13] Lien on shares; setoff

In Section 13 the borrowers authorize a lien on their shares at the credit union to secure the R.E.A.P. plan. Tax-exempt accounts are not subject to the lien and setoff. The lien may not be enforceable if the plan has credit card access. On Wisconsin Consumer R.E.A.P. plans, setoff is only available upon expiration of the Notice of Right to Cure Default, if applicable.

Section [14] Amendments

As required by Reg. Z § 226.5b, the plan provides that it may be amended only by written agreement by the Borrowers and the credit union, except for insignificant changes, changes unequivocally beneficial to the borrower, and replacing an unavailable index.

Section [15] Default

This section sets forth the grounds for default under the plan, depending on whether it is subject to the Wisconsin Consumer Act.

Sections [16] – [20] Miscellaneous contract clauses

Section [21] Blank

Blank space is provided here to allow the credit union to add additional clauses, or to add excess language that is continued from another section. Be sure that any additional clauses comply with Reg. Z and the Wisconsin Consumer act, and that they do not contradict other provisions of the HELOC plan.

JCE
5/2005