

permissible under section 202.6(b)(2)(iv). In addition, under section 202.6(b)(2)(iii), a creditor may consider a borrower's age to evaluate a pertinent element of creditworthiness, such as the amount of the credit or monthly payments that the borrower will receive, or the estimated repayment date.

\* \* \* \* \*

5. In Supplement I to Part 202, Section 202.7—Rules Concerning Extensions of Credit, is amended as follows:

a. Under Paragraph 7(d)(2), paragraph 1. is revised; and

b. Paragraph 7(d)(6) is revised.

The revisions read as follows:

\* \* \* \* \*

Section 202.7 Rules Concerning Extensions of Credit

\* \* \* \* \*

Paragraph 7(d)(2)

1. *Jointly owned property.* If an applicant requests unsecured credit, does not own sufficient separate property, and relies on joint property to establish creditworthiness, the creditor must value the applicant's interest in the jointly owned property. A creditor may not request that a nonapplicant joint owner sign any instrument as a condition of the credit extension unless the applicant's interest does not support the amount and terms of the credit sought.

i. *Valuation of applicant's interest.* In determining the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the form of ownership prior to or at consummation, and not on the possibility of a subsequent change. For example, in determining whether a married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property may be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the nonapplicant spouse in these or similar circumstances.

ii. *Other options to support credit.* If the applicant's interest in jointly owned property does not support the amount and terms of credit sought, the creditor may offer the applicant other options to provide additional support for the extension of credit. For example—

A. Requesting an additional party (see § 202.7(d)(5));

B. Offering to grant the applicant's request on a secured basis (see § 202.7(d)(4)); or

C. Asking for the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (e.g., a limited guarantee). A

creditor may not routinely require, however, that a joint owner sign an instrument (such as a quitclaim deed) that would result in the forfeiture of the joint owner's interest in the property.

\* \* \* \* \*

Paragraph 7(d)(6)

1. *Guarantees.* A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only from the married officers of a business or married shareholders of a closely held corporation.

2. *Spousal guarantees.* The rules in § 202.7(d) bar a creditor from requiring a signature of a *guarantor's spouse* just as they bar the creditor from requiring the signature of an *applicant's spouse*. For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of a spouse in appropriate circumstances in accordance with § 202.7(d)(2).

\* \* \* \* \*

6. In Supplement I to Part 202, Section 202.13—Information for Monitoring purposes, is amended as follows:

a. Under 13(a) *Information to be requested.*, paragraph 6. is revised; and

b. Under 13(b) *Obtaining of information.*, paragraphs 4. and 5. are redesignated as paragraphs 6. and 7., respectively, and new paragraphs 4. and 5. are added.

The revisions and additions are to read as follows:

\* \* \* \* \*

Section 202.13 Information for Monitoring purposes

13(a) *Information to be requested.*

\* \* \* \* \*

6. *Refinancings.* A refinancing occurs when an existing obligation is satisfied and replaced by a new obligation undertaken by the same borrower. A creditor that receives an application to refinance an existing extension of credit made by that creditor for the purchase of the applicant's dwelling may request the monitoring information again but is not required to do so if it was obtained in the earlier transaction.

\* \* \* \* \*

13(b) *Obtaining of information.*

\* \* \* \* \*

4. *Applications through electronic media.* If an applicant applies through an electronic medium (for example, the Internet or a facsimile) without video capability that allows the creditor to see the applicant, the creditor may treat the application as if it were received by mail or telephone.

5. *Applications through video.* If a creditor takes an application through a medium that allows the creditor to see the applicant, the creditor treats the application as taken in person and must note the monitoring information on the basis of visual observation or surname, if the applicant chooses not to provide the information.

\* \* \* \* \*

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, September 24, 1996.

Jennifer J. Johnson,

*Deputy Secretary of the Board.*

[FR Doc. 96-24917 Filed 9-27-96; 8:45 am]

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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 545, 556, 560, 563, 566, 571, 590

[No. 96-87]

RIN 1550-AA94

Lending and Investment

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS or Office) is today issuing a final rule updating, reorganizing, and substantially streamlining its lending and investment regulations and policy statements. These amendments are being made pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review (Reinvention Initiative) and section 303 of the Community Development and Regulatory Improvement Act of 1994 (CDRIA), which requires OTS and the other federal banking agencies to review, streamline, and modify regulations and policies to improve efficiency, reduce unnecessary costs, and remove inconsistent, outmoded, and duplicative requirements.

EFFECTIVE DATE: October 30, 1996.

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906-6445, Regulations and Legislation Division, Chief Counsel's Office. For information about preemption, contact Evelynne Bonhomme, Counsel (Banking and Finance), (202) 906-7052, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, D.C. 20552.

#### SUPPLEMENTARY INFORMATION:

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##### I. Background

In a comprehensive review of its regulations, beginning in the spring of 1995, pursuant to section 303 of the CDRIA<sup>1</sup> and the Administration's Reinvention Initiative, OTS identified its lending and investment regulations as an important area for updating and streamlining. Lending and investment are key areas of thrift operations and these regulations had not been comprehensively reviewed in a number of years. Each lending and investment regulation was reviewed to determine whether it was current and understandable; could be eliminated without endangering safety and soundness, diminishing consumer protection or violating statutory requirements; addressed subject matter more suited for handbook guidance; and was consistent with the regulations of the other banking agencies. OTS also sought industry input regarding staff's initial recommendations through an industry focus group meeting among seven thrift representatives, an industry trade association and OTS staff. As a result of this review, OTS identified a number of ways in which its lending and investment regulations could be revised to reduce regulatory burden. On January 17, 1996, OTS issued a notice of proposed rulemaking.<sup>2</sup>

Today's final rule is substantially similar to the January proposal. Readers will note, however, that the final rule also sets forth, for ease of reference, the

full text of OTS's regulations on lending limits, real estate lending standards, disclosures on adjustable-rate mortgages, and the reappraisal of real estate owned (REO). These regulations have been moved, with only technical and conforming changes, into new Part 560, Lending and Investment, so that all lending regulations will be grouped together and more easily located. The final rule also incorporates technical corrections to fix cross-references in other regulations to regulations that are being modified, moved, or removed as part of this final rule.

The final rule reduces the number of lending and investment regulations from 43 to 23 and results in a net reduction of 11 pages of CFR text. As it proposed, OTS has removed unnecessary, duplicative, and outdated lending and investment regulations such as § 563.97 (loans in excess of 90% of value), § 545.44 (mortgage transactions with the Federal Home Loan Mortgage Corporation (Freddie Mac)), and § 545.37 (combination loans). OTS has also revised certain regulations to be less burdensome, *e.g.*, amending the scope of commercial loans under current § 545.46(b) to exclude commercial loans made by service corporations from its parent's percentage-of-assets limitations and removing restrictions on manufactured home loans and investments in government securities and state housing corporations.

OTS has also converted the detail in some regulations into guidance to give thrifts more flexibility in addressing safety and soundness concerns in a particular area, *e.g.*, current § 563.160 (loan classification) and current § 563.170(c) (loan documentation). OTS's movement toward a more guidance-oriented approach in the lending and investment area brings OTS's regulations into greater uniformity with those of the other federal banking agencies consistent with the objectives of section 303 of the CDRIA.

OTS's objective in removing the detail from some regulations and relying on a more general set of regulations and safety and soundness standards is to allow institutions greater flexibility in their lending and investment operations. However, OTS still insists that an association maintain adequate loan documentation, classify its assets, and establish appropriate valuation allowances consistent with generally accepted accounting principles and safety and soundness.

OTS is also sensitive to commenters' concerns regarding the potential for examiners to treat guidelines as binding

regulations. OTS will emphasize the proper interpretation of supervisory guidance in its examiner training programs to ensure that guidance is not treated in the same manner as binding regulations.

OTS has also reorganized its lending and investment regulations to make them easier to locate and use. First, all lending and investment regulations have been moved to a new Part 560, "Lending and Investment," that specifies which regulations apply to all savings associations (such as loan documentation, disclosure, and real estate lending standards) and which apply only to federal savings associations (such as specific lending powers.) This part incorporates provisions currently located in Parts 545 and 563 that are being modified as part of today's final rule. It also incorporates sections currently located in Part 563 that are being transferred to Part 560 without change. These regulations—real estate lending standards, disclosure requirements for adjustable-rate mortgages, lending limits, and appraisal requirements for real estate owned—are being moved to Part 560 for the convenience of those using OTS's lending regulations.

OTS has also removed unnecessary restatements of statutory authority and limitations from various sections of Part 545 and replaced them with a regulation in chart format that provides easy reference to the statutory authority for, and limitations on, federal associations' lending and investment powers.

OTS has added a general lending preemption provision in new Part 560. This provision (discussed more fully in the section-by-section analysis in Sec. II.B. below) restates long-standing preemption principles applicable to federal savings associations, as reflected in earlier regulations, court cases, and numerous legal opinions issued by OTS and the Federal Home Loan Bank Board (FHLBB), OTS's predecessor agency. In those opinions, OTS has consistently taken the position that, with certain narrow exceptions, any state laws that purport to affect the lending operations of federal savings associations are preempted. None of the changes implemented today should be construed as evidencing in any way an intent by OTS to change this long held position: OTS still intends to occupy the field of lending regulation for federal savings associations. OTS believes that the new lending preemption regulation is clearer and should significantly reduce the instances in which institutions need to request interpretive guidance from OTS.

In summary, OTS believes that regulations that address safety and

<sup>1</sup> 12 U.S.C. 4803(a)(1).

<sup>2</sup> 61 FR 1162 (January 17, 1996).

soundness requirements should generally be limited to those requirements necessary for OTS to carry out its supervisory responsibilities. If regulations are unnecessarily detailed and rigid, regulated entities may find themselves unable to respond to market innovations. Today's final rule achieves what OTS believes is the right balance by placing essential safety and soundness requirements in binding regulations and putting more expansive guidance on sensible practices in handbooks.

## II. Summary of Comments and Description of the Final Rule

### A. General Discussion of the Comments

The public comment period on the January 17 proposal closed on April 16, 1996. Fourteen commenters responded to the notice of proposed rulemaking. Seven federal savings associations, three national financial institution trade associations, two law firms, one national bank, and one state appraiser trade association submitted comments.

All but one of the commenters generally supported OTS efforts to update, streamline, and reorganize its lending and investment regulations. Commenters praised OTS's proposed elimination of unnecessary and burdensome lending and investment restrictions and indicated that the proposed modifications would be helpful. Commenters believed that the proposed changes would significantly reduce the compliance burden on the thrift industry and facilitate greater operational flexibility and product innovation. Commenters generally concurred with OTS's view that many of the proposed amendments would provide savings associations with the flexibility needed to compete with other financial institutions, particularly commercial banks, to engage in new lending activities made possible by technological changes, and to respond more quickly to market innovation. Most commenters also supported the consolidation of all lending and investment regulations into a new Part 560.

Commenters also generally supported OTS's proposal to shift some of its regulations to guidance in the Thrift Activities Handbook (Handbook). Commenters noted that moving specific loan documentation requirements currently found in § 563.170, specific loan classification requirements currently in § 563.160, and restrictions on investments in commercial paper and corporate debt securities currently in § 545.75 into the Handbook was appropriate, given that OTS now has

more sophisticated examination and reporting methods and better trained examiners to monitor thrift activities. Commenters recognized that OTS regulations traditionally have been more detailed and less flexible than those applicable to banks. They agreed that OTS's proposal to move from a somewhat regulation-specific to a more guidance-oriented approach would give thrifts more flexibility to address safety and soundness concerns in a manner best suited to each individual institution. Commenters also believed that shifting OTS regulations into the Handbook would reduce the costs of regulatory compliance by increasing a thrift's operational flexibility.

At least one commenter was concerned, however, that the Handbook could become so detailed that it would stifle product innovation and management judgment or duplicate provisions that remained in the regulations. Commenters also expressed the concern that examiners might view guidelines in the Handbook as binding requirements with no resulting relief in regulatory burden. To prevent this, commenters supported OTS's plan to provide examiner training that would emphasize the intended flexibility of supervisory guidance. Additionally, OTS is reviewing the text of regulations being repealed today to determine what portions will provide helpful guidance and what portions should be disposed of altogether. The process of converting regulatory text to guidance will be done thoughtfully, recognizing the different roles performed by regulations and guidance.

A number of commenters raised concerns that the proposed changes on preemption of state laws affecting lending might be misunderstood as a narrowing of OTS's traditional preemption position. These concerns are discussed in detail in the section-by-section analysis below in reference to § 560.2.

### B. Section-by-Section Analysis

#### 1. Existing Lending and Investment Sections

##### *Section 545.31 Election Regarding Classification of Loans or Investments*

OTS proposed retaining in modified form paragraph (a) of § 545.31, which set forth OTS's general rule that where a loan or investment meets the requirements of more than one authorizing provision, the association may elect to place it in any applicable category. OTS received no comments on this paragraph, which is retained as proposed, in modified form, as new § 560.31.

OTS also proposed retaining paragraph (b) of § 545.31, which provided that loan commitments are included in total assets and accounted for as an investment for purposes of determining applicable statutory or regulatory investment authority limitations only to the extent that funds are advanced and not repaid.<sup>3</sup> OTS received no comments on this paragraph, which is retained as proposed as part of new § 560.31(a).

OTS proposed retaining paragraphs (c) and (d) of § 545.31, which addressed respectively the treatment of loans sold to third parties for purposes of calculating percentage-of-assets investment limitations and treatment of loans secured by assignment of loans. OTS received no comments on these paragraphs, which are retained in new § 560.31. One commenter addressing the treatment of commercial loans did suggest that OTS explicitly state that commercial loans sold or participated out do not count toward a thrift's 10 percent commercial loan limit. OTS believes that new § 560.31(b), which provides that loans sold to a third party are only included in calculating a percentage-of-assets investment limitation to the extent that they are sold with recourse, addresses this point. In response to the commenter, OTS is adding the phrase "or portions of loans" to the regulation to clarify that any portion of participation loans sold without recourse need not be aggregated when calculating loans subject to any percentage-of-assets investment limit.

The January proposal indicated that the definitions of "real estate loan" and "loan commitment" would be addressed in a later rulemaking that would review the overall structure of OTS's regulations and might move OTS regulatory definitions into a common part of the Code of Federal Regulations (CFR) (the Regulatory Structure rulemaking). In order to avoid confusion pending that rulemaking, however, OTS has decided to incorporate these definitions, substantially unchanged, into a new "Definitions" section, § 560.3. The future Regulatory Structure rulemaking may review these definitions to determine if they should be modified, removed, or relocated to another location in the regulations.

<sup>3</sup>Today's final rule carries forward this longstanding treatment of loan commitments for purposes of HOLA section 5(c) investment limitations. OTS notes, however, that contractual commitments to advance funds continue to be considered "loans and extensions of credit" under the loans-to-one borrower regulation (existing § 563.93, now § 560.93).

*Section 545.32 Real Estate Loans*

Consistent with its regulatory streamlining efforts, OTS proposed deleting paragraph (a) of § 545.32 and moving its statutory reference into the new lending and investment powers chart. Paragraph (a) reiterated the Home Owners' Loan Act's (HOLA's) general grant of authority for federal savings associations to make or invest in residential (home) or nonresidential real estate loans<sup>4</sup> and explicitly authorized federal savings associations to "originate, invest in, sell, purchase, service, participate or otherwise deal in (including brokerage and warehousing) [real estate] loans." One commenter did suggest that OTS clarify that deletion of paragraph (a) is not intended to eliminate any of the activities in which federal savings associations may engage with respect to real estate loans. OTS is deleting paragraph (a) as proposed. However, OTS wishes to emphasize that it does not intend any change in federal thrifts' authority to conduct these activities. OTS is moving the statutory reference in paragraph (a) into the new lending and investment powers chart at § 560.30.

OTS also proposed to delete paragraphs (b)(1) and (b)(2) of § 545.32, because these sections duplicated more comprehensive interagency-developed real estate lending standards and appraisal standards set forth at 12 CFR 563.100–563.101 and 12 CFR Part 564, respectively. OTS received no comments on these paragraphs and is deleting them as proposed. As part of today's rulemaking, the real estate lending standards are being moved into Part 560 as new § 560.100–560.101.

OTS also proposed deleting paragraphs (b) (3), (4), (5), and (6) of § 545.32. These paragraphs discussed federal savings associations' authority to adjust the terms of real estate loans, to amortize real estate loans, to charge certain initial fees for real estate loans, and to establish escrow accounts. OTS believes that the authority to adjust, amortize, establish escrow accounts for, and charge fees for loans properly falls within the scope of a federal savings association's statutory authority to originate loans pursuant to the HOLA,<sup>5</sup> and these particular aspects of lending do not need to be specifically identified or restricted in the CFR. Although commenters generally supported elimination of these paragraphs, one commenter raised the concern that if OTS removed specific regulatory language referring to the authority of

federal thrifts to adjust terms, amortize, charge certain fees, and establish escrow accounts for real estate loans, states may challenge whether OTS continues to occupy the field of federal thrift lending regulation and may attempt to impose their own lending regulations on thrifts. However, by removing these paragraphs, OTS does not intend any narrowing of federal thrifts' authority to conduct these activities, but rather to enhance associations' flexibility in lending. Each of these areas is specifically cited in the new § 560.2 as an area in which state law is preempted. Whether OTS continues to have a specific regulation or chooses to remove a federal regulation to streamline its regulations and reduce regulatory burden, the agency still intends to occupy the entire field of lending regulation for federal savings associations. Accordingly, OTS is deleting paragraphs (b) (3), (4), (5), and (6) as proposed.

Paragraph (c) of § 545.32 defined the phrase "loan made on the security of real estate." In its proposal OTS sought comment on whether the current definition of secured real estate loan has provided adequate guidance for savings associations. One commenter indicated that the current definition does not adequately deal with situations involving state single action rules. OTS will consider this comment when the agency proceeds with the definitional portion of the Regulatory Structure rulemaking. In the interim, this definition is being included in § 560.3, "Definitions."

OTS proposed deleting paragraph (d) of § 545.32, which addressed loan-to-value ratios, because it duplicates more comprehensive interagency real estate lending standards. Commenters supported elimination of this paragraph and OTS is deleting paragraph (d) as proposed.

*Section 545.33 Home Loans*

In the proposal, OTS indicated that it was considering moving the introductory paragraph of § 545.33 to a common definitional section of the regulations as part of the Regulatory Structure Proposal. OTS received no comments on this language, which generally describes home loans and will retain this paragraph as part of § 560.3 "Definitions," until its reconsideration during the definitional rulemaking.

OTS proposed to delete paragraph (a) of § 545.33. This section described the authority of federal savings associations to amortize home loans. One commenter did raise a concern that deletion of this section could throw into question federal preemption of state laws prohibiting balloon payments. As

discussed under § 545.32(b) (3)–(6), the authority to amortize home loans properly falls within the scope of savings associations' statutory authority to originate loans and does not need to be specifically identified in the CFR. New § 560.2 specifically confirms that states cannot regulate how federal savings associations amortize their loans. Accordingly, OTS is deleting paragraph (a) as proposed.

OTS proposed to delete paragraph (b), which addressed loan-to-value ratios (LTV) for home loans. Commenters agreed with OTS's view that the interagency real estate lending standards address the same issues in a more comprehensive and current manner and supported deletion of this paragraph. OTS is deleting paragraph (b) as proposed.

One commenter did contend that some language in paragraph (b) should be retained to make clear that home loans that comply at origination with the LTV ratios set forth in the interagency real estate lending standards but thereafter exceed them due to negative amortization should not require special recordkeeping or reporting to a thrift's board of directors. OTS has no requirement in either the real estate lending guidelines or its regulations that such loans be reported to a thrift's board and so removing this paragraph does not impose any new reporting requirements on thrifts.

OTS proposed to delete paragraph (c), which set forth limitations on the adjustments that may be made to the terms of residential mortgages. It requires that adjustments to rates, payments, or loan balances be tied to a national or regional index beyond the control of the savings association or a formula or schedule set forth in the loan contract. These limitations on federal savings associations are generally much more restrictive than those applicable to state-chartered lenders offering mortgages and have not been revised since 1983, when adjustable rate mortgage (ARM) loans were still relatively new in the marketplace. Federal savings associations must also comply with the notice and disclosure requirements of current § 563.99.

OTS proposed to delete paragraph (c), including the external index requirement, to give thrifts and consumers greater flexibility in structuring ARM transactions. Most commenters supported the proposed deletion, agreeing that it would give thrifts additional flexibility to compete with other mortgage lenders not subject to similar requirements. These commenters also agreed that the competitive market place makes such

<sup>4</sup> 12 U.S.C. 1464(c)(1)(B), (c)(2)(B).

<sup>5</sup> 12 U.S.C. 1464(c)(1)(B), (c)(2)(B).

requirements unnecessary given the wide variety of possible sources for home mortgage loans. Commenters also confirmed that consumers have become familiar with ARM loans and receive detailed disclosures when requesting such loans. The majority of commenters addressing the issue concluded that as long as information about adjustments is clearly disclosed to purchasers, the terms of the ARM loan should be a matter of contract between the savings association and the purchaser.<sup>6</sup>

One commenter, a bank trade association, opposed the removal of this requirement, arguing that it would be inconsistent with the Office of the Comptroller's decision to retain such a requirement for national banks.<sup>7</sup> Another commenter, a trade association representing savings associations and banks, suggested further study before removing the requirement. Both commenters suggested that consumers might be better protected by retaining this requirement. The second commenter emphasized the importance of adequate disclosure.

Upon review of the comments received, OTS has decided to adopt a new section, § 560.35, "Adjustments to Home Loans," requiring that a federal savings association generally use a national or regional index for ARM loans. Examples of such acceptable indices include the Eleventh District's Cost of Funds Index and indices tied to one-year Treasury bills. OTS has also decided, however, to give an association the flexibility to use alternative indices after notifying OTS. The notice should address how indices will be derived, how the association will ensure the indices' availability and verifiability, and how the indices will be disclosed to borrowers. Additionally, the notice should outline the internal controls and processes that the association will put in place to administer and monitor such indices. Once OTS has reviewed and not objected to an institution's internal procedures for the use of alternative indices, subsequent notices need only address how new indices are derived. If OTS does not object within 30 days, the association may proceed with using alternative indices. Use of alternative indices will also be reviewed as part of the agency's safety and soundness and compliance examinations.

The foregoing changes do not affect the requirement that any index used

must be readily available, independently verifiable, and adequately disclosed in accordance with the Truth in Lending Act, any applicable regulations, and new § 560.210, which replaces existing § 563.99. Associations still may use one or more indices or a formula or schedule set forth in the loan contract to adjust the interest rate, payments, or loan balance.

OTS believes that this change will allow institutions potentially greater flexibility in structuring and managing their loan portfolios while allowing the agency the opportunity to review an association's proposed ARM loan program, structure, and safeguards to determine whether they would result in a suitable index to use for ARM transactions. Consumers will continue to have the protection of a verifiable and disclosed index and of OTS review. In response to the commenters who noted that the Office of the Comptroller of the Currency (OCC) has recently taken a different position on this issue, OTS notes that the external indices issue is more important for federal thrifts than it is for national banks. Unlike banks, thrifts are subject to the Qualified Thrift Lender (QTL) rule. That statutorily mandated rule, 12 CFR 563.50–563.52, requires thrifts to hold an average of 65% or more of their assets in residential mortgage loans. Because national banks have no such requirement, they often originate such loans, but then sell them in the secondary mortgage market. They rarely would have the occasion to develop an alternative index because the secondary market usually requires the use of an outside index.

Because thrifts must hold the majority of their assets in residential mortgages, they are more vulnerable to interest rate risk than national banks. Enabling thrifts to tie their yields on 1–4 family residential loans with the rates they pay on deposits would help thrifts to manage this risk and offset the competitive disadvantage resulting from the QTL rule.

No commenters addressed the other requirements of § 545.33(c) (4)–(5), which are being removed as proposed.

OTS proposed to delete paragraph (d) of § 545.33, which addressed loans on cooperatives. Commenters agreed with OTS's view that the interagency real estate lending standards address the same issues in a more comprehensive and flexible manner and that this paragraph was duplicative of those lending standards. OTS is deleting paragraph (d) as proposed.

OTS proposed deleting paragraph (e) of § 545.33, which addressed loans to

facilitate trade-in or exchange, because the interagency real estate lending standards cover the same issues in a more comprehensive and flexible manner. Commenters supported deletion of this paragraph. OTS is deleting paragraph (e) as proposed.

Paragraph (f) of § 545.33 specifies which OTS regulations must be followed by state savings associations and certain other state lenders who elect to make loans under the Alternative Mortgage Parity Act.<sup>8</sup> The Alternative Mortgage Parity Act preempts state laws that might otherwise limit certain state creditors' ability to offer alternative mortgage instruments if they comply with the OTS regulations identified in this paragraph. OTS proposed moving paragraph (f) in order to make it more accessible and easier to locate and to clarify that all OTS lending regulations apply to loans originated under the Parity Act. OTS received no comments on this proposed change. Accordingly, OTS is moving the provisions of this paragraph, as modified to reflect changes elsewhere in today's final rule, into new § 560.220, as part of a subpart specifically dealing with alternative mortgages. The title of that subpart and § 560.220, will highlight the content, making it easier for those unfamiliar with OTS's regulations to locate.

#### *Section 545.34 Limitations for Home Loans Secured by Borrower-Occupied Property*

OTS proposed removing paragraph (a) of § 545.34 and incorporating its provisions into the new consolidated lending preemption regulation at § 560.2. Paragraph (a) confirmed that federal savings associations may include due-on-sale clauses in loan instruments to the extent authorized under federal statutes and regulations regardless of state prohibitions of due-on-sale clauses.<sup>9</sup> OTS received no comments on this proposed change, which is adopted as proposed.

Paragraphs (b) and (c) permitted federal savings associations to include provisions imposing late fees and prepayment penalties in loan contracts on home loans subject to certain conditions. OTS proposed removing these paragraphs and incorporating their limitations into new § 560.34. The three commenters who discussed these

<sup>6</sup>One commenter suggested removing all caps on ARM loans. The OTS notes that 12 U.S.C. 3806, which applies to all creditors, including savings associations, requires that all ARM loans, as defined in that section, include limitations on the maximum interest rate applicable during the loan term.

<sup>7</sup>See 61 FR 11294, 11297 (March 20, 1996).

<sup>8</sup>The Alternative Mortgage Parity Act, Pub. L. 97–320, Title VII (Parity Act), 12 U.S.C. 3801 *et seq.*, authorizes certain housing creditors to make alternative mortgage transactions notwithstanding any contrary state law under certain conditions. Housing creditors that rely on the Parity Act and are not commercial banks or credit unions must comply with applicable OTS lending regulations.

<sup>9</sup>12 U.S.C. 1701j–3; 12 CFR Part 591.

paragraphs supported this reorganization. Upon further review, however, OTS believes that separating these two paragraphs into two separate, more specifically identified, regulations will make them easier for users to locate. New § 560.33 will cover late charges and new § 560.34 will address prepayment penalties.

Two commenters also suggested that OTS reduce or eliminate the required fifteen-day grace period for borrowers before imposition of a late charge. The commenters noted that only OTS, among federal bank regulators, has such a lengthy grace period, and suggested at least reducing the period to ten days to put savings associations on a more level playing field with other mortgage lenders. OTS believes that the fifteen-day grace period does not impose a hardship on institutions. OTS is retaining the fifteen-day grace period in the final rule.

One commenter also suggested that OTS delete the reference to "monthly" billing in § 545.34(b) (now incorporated into § 560.33), inasmuch as some creditors offer bi-weekly or other mortgage plans. OTS is adopting this suggestion and deleting the word "monthly" from the final rule in order to afford institutions and consumers more flexibility in structuring payment plans.

#### *Section 545.35 Other Real Estate Loans*

Section 545.35 set forth federal savings associations' authority to lend and invest in nonresidential real estate subject to certain statutory and regulatory limitations. Paragraph (a) required compliance with real estate lending standards. Paragraph (b) reiterated the statutory limit of 400 percent of an association's total capital imposed on investments in nonresidential real estate. Pursuant to its streamlining efforts, OTS proposed to delete this section, incorporate the reference to federal savings associations' statutory authority to invest in nonresidential real estate into the lending and investment powers chart, and place related limitations into an accompanying endnote. OTS received no comments on § 545.35 and is making the changes proposed.

#### *Section 545.36 Loans To Acquire or To Improve Real Estate*

OTS proposed to delete § 545.36, which set forth regulatory investment limitations pertaining to acquisition, development, and construction loans. The one commenter addressing this proposed change supported OTS's view that the interagency real estate lending

standards and interagency safety and soundness standards dealt with the same issues in a more comprehensive and current manner. Accordingly, OTS is deleting this section as proposed. OTS intends to incorporate paragraphs (c) and (d) of § 545.36 into the Handbook to provide guidance beyond that contained in the interagency real estate lending standards to thrifts making development loans.

#### *Section 545.37 Combination Loans*

OTS is deleting § 545.37 as proposed. This section allowed thrifts to combine sequentially different types of loans authorized by Part 545 and made at different stages of a project, with the term of each loan beginning at the end of the previous loan. This provision was useful when OTS regulations limited the number of years for which certain types of loans could be made. OTS removed those restrictions in 1992. OTS believes this section is therefore no longer necessary. The sole commenter addressing this section supported its deletion.

#### *Section 545.38 Insured and Guaranteed Loans*

Paragraphs (a) and (b) of § 545.38 authorized federal thrifts to make insured and guaranteed residential real estate loans, notwithstanding other provisions of Part 545 but subject to certain limitations. OTS proposed deleting these paragraphs as unnecessary. Federal savings associations may make an unlimited percentage of residential real estate loans, subject to the interagency real estate lending standards. Other regulatory restrictions have already been removed or are being deleted from Part 545 today. OTS received no comments on these proposed deletions, which are adopted as proposed.

Paragraph (c) addressed nonresidential real estate loans that are guaranteed by the Economic Development Administration, the Farmers Home Administration, or the Small Business Administration. OTS proposed deleting this paragraph and incorporating the HOLA's statutory grant of authority for federal thrifts to make guaranteed nonresidential real estate loans in the endnotes to the lending and investment powers chart. The sole commenter addressing § 545.38 supported deletion of the section as unnecessary and duplicative of the interagency real estate lending standards.

Accordingly, OTS is deleting this paragraph as proposed and incorporating the statutory reference

into the lending and investment powers chart.

#### *Section 545.39 Loans Guaranteed Under the Foreign Assistance Act of 1961*

OTS proposed deleting § 545.39, which reiterated the HOLA's grant of authority<sup>10</sup> to federal thrifts to make loans guaranteed under the Foreign Assistance Act,<sup>11</sup> and incorporating its provisions into the lending and investment powers chart. OTS received no comments on this section. OTS is incorporating the provisions of § 545.39 into the lending and investment powers chart and endnotes and new § 560.43.

#### *Section 545.40 Loans on Low-Rent Housing*

OTS proposed to delete § 545.40, which exempted loans made pursuant to certain low rent housing programs of the Department of Housing and Urban Development from regulatory maximum loan term and loan-to-value limitations. OTS believes that this section is unnecessary because the loan term and loan-to-value ratio limitations referred to in the section have already been or are now being removed from OTS regulations. The one commenter who addressed this section supported its elimination. Accordingly, OTS is deleting this section as proposed. By deleting this section, OTS does not intend to limit federal thrifts' authority to make low-rent housing loans pursuant to applicable statutory and regulatory provisions, but rather to remove obsolete restrictions that only serve to confuse those using OTS's regulations.

#### *Section 545.41 Community Development Loans and Investments*

OTS proposed to delete § 545.41 because it simply reiterated the HOLA's grant of authority to federal savings associations to make direct community development loans and investments, subject to an overall five percent of assets limitation.<sup>12</sup> OTS received no comments on this proposed change. OTS is deleting this section as proposed and incorporating the statutory authority reference into the lending and investment powers chart.

#### *Section 545.42 Home Improvement Loans*

Section 545.42 reiterated the HOLA's grant of authority to federal thrifts to make home improvement loans subject to prudent lending standards.<sup>13</sup> OTS

<sup>10</sup> 12 U.S.C. 1464(c)(4)(C).

<sup>11</sup> 22 U.S.C. 2181, 2184.

<sup>12</sup> 12 U.S.C. 1464(c)(3)(B).

<sup>13</sup> 12 U.S.C. 1464(c)(1)(J).

proposed deleting this section and incorporating the reference to federal thrifts' statutory authority to make home improvement loans into the lending and investment powers chart. OTS received no comments on § 545.42 and is making the proposed changes.

*Section 545.43 State Housing Corporation Investment-Insured*

OTS proposed to delete § 545.43 because it reiterated the HOLA's grant of authority to federal thrifts to invest in state housing corporation loans<sup>14</sup> subject to a regulatory 30 percent of assets limitation. This section also duplicates restrictions in current § 563.95, which regulates investment in state housing corporations for all savings associations.<sup>15</sup> OTS received no comments on this section. OTS is deleting § 545.43, as proposed, including the 30 percent of assets limitation. The reference to the HOLA's grant of authority to federal thrifts to invest in state housing corporation loans has been incorporated into the lending and investment powers chart.

*Section 545.44 Mortgage Transactions With the Federal Home Loan Mortgage Corporation*

Section 545.44 provided, in accordance with HOLA section 5(c)(1)(E) and the Federal Home Loan Mortgage Corporation Act, that federal thrifts may enter into or perform mortgage transactions with Freddie Mac. It did not impose any additional regulatory restrictions. OTS proposed to delete this section as an unnecessary reiteration of statutory authority and of savings associations' inherent power to enter into business contracts. The sole commenter addressing § 545.44 supported its deletion as unnecessary. OTS is deleting § 545.44 as proposed. HOLA section 5(c)(1)(E) is now referenced in the lending and investment powers chart.

*Section 545.45 Manufactured Home Financing*

OTS proposed to delete paragraph (a) of § 545.45, which contained definitions relating to manufactured home financing. The proposed deletion of other paragraphs of this section made these definitions unnecessary. OTS received no comments on this paragraph and is deleting it as proposed.

OTS proposed to delete paragraph (b) of § 545.45, which reiterated the HOLA's grant of authority to federal thrifts to invest in or make

manufactured home loans.<sup>16</sup> The two commenters addressing this section supported these streamlining efforts, and OTS is deleting paragraph (b) as proposed. OTS is incorporating the statutory reference to federal thrifts' authority to invest in manufactured home loans into the lending and investment powers chart.

Paragraphs (c) and (d) of § 545.45 addressed inventory financing and retail financing for manufactured home chattel paper and established term and loan-to-value limits for such loans. OTS proposed deleting these paragraphs because they describe underwriting standards for manufactured homes that are more suitable as guidance. The two commenters addressing these paragraphs supported removing loan-to-value and maximum term limits on manufactured homes to eliminate micromanagement of the lending process. Accordingly, OTS is deleting these paragraphs as proposed.

However, the commenters disagreed as to the extent to which these paragraphs should be transferred to the Handbook. One commenter suggested that underwriting guidance in the Handbook pay particular attention to the unique risk characteristics associated with manufactured home financing. The second commenter believed that limitations in the Handbook would not necessarily produce better manufactured home loan performance but rather would only limit credit availability for low and medium income borrowers and leave thrifts at a competitive disadvantage with regard to other types of institutions. This commenter contended that a prudent underwriting program that balanced creditworthiness and payment capacity of a borrower along with product parameters, pricing differentials, and reserve requirements provided a better means for managing risk than a program containing strict limits on particular factors.<sup>17</sup> OTS will review these suggestions prior to issuing any guidance regarding mobile home lending.

OTS proposed to delete paragraph (e) of § 545.45, which provided that a federal thrift's sale of manufactured home chattel paper must be sold

without recourse. Since that paragraph was first adopted, OTS has adopted a capital regulation that requires thrifts to hold appropriate levels of capital against all sales with recourse.<sup>18</sup> OTS received no comments on this proposed change and is deleting paragraph (e) as proposed.

*Section 545.46 Commercial Loans*

OTS proposed to delete paragraph (a) of § 545.46, which simply reiterated the HOLA's grant of authority to federal thrifts to invest in and make commercial loans not to exceed 10 percent of their assets.<sup>19</sup> OTS also proposed to incorporate the authority and statutory limitation in paragraph (a) into the lending and investment powers chart. Commenters generally supported these proposed changes, which are adopted as proposed.

OTS also proposed deleting paragraph (b), which defined commercial loans to include commercial overdrafts related to demand accounts and commercial unsecured loans by service corporations. OTS proposed to incorporate paragraph (b)(1) (commercial overdrafts) into an endnote to the lending and investment powers chart. OTS received no comments on this proposed change, which is adopted as proposed.

OTS also proposed to remove the requirement that commercial loans made at the service corporation level be aggregated with the 10 percent of assets limit on commercial lending. Commenters generally agreed with OTS's view that the statutory maximum aggregate 3 percent of assets that federal savings associations may invest in service corporations<sup>20</sup> generally provides a sufficient safeguard for savings associations investing in service corporations engaged in commercial lending as it does for all other types of activities conducted in service corporations. Under the current regulations, only a service corporation's commercial loans are aggregated with its parent's loans for purposes of statutory percentage-of-assets limitations on general investment authority, while other service corporation investments are not.<sup>21</sup> Most commenters agreed with

<sup>16</sup> 12 U.S.C. 1464(c)(1)(I).

<sup>17</sup> This commenter also suggested expanding the definition of residential property in existing § 563.101 (now § 560.101) of the interagency real estate lending standards to include manufactured homes placed on real property regardless of whether the home is permanently affixed as determined by state law. The OTS believes that modifying the substance of that section, which was developed on an interagency basis, is not within the scope of this rulemaking and defers consideration of this suggestion until a later date.

<sup>18</sup> See 12 CFR 567.1(kk), 567.6(a)(2)(i)(C).

<sup>19</sup> 12 U.S.C. 1464(c)(2)(A). The language in § 545.46(a) regarding pre-1984 investment limits is obsolete and has been deleted.

<sup>20</sup> 12 U.S.C. 1464(c)(4)(B).

<sup>21</sup> 12 CFR 545.74(c)(1)(1996). For purposes of some other regulations, such as loans to one borrower (12 CFR 563.93, to be recodified at 12 CFR 560.93) and transactions with affiliates (12 CFR 563.41 and 563.42), investments at the service corporation level are aggregated with investments of

<sup>14</sup> 12 U.S.C. 1464(c)(1)(P).

<sup>15</sup> Section 563.95, as discussed later, is being modified and moved into new Part 560.

OTS that such a distinction is not warranted and that such loans should no longer be subject to the 10 percent of assets limitation on commercial lending set forth in HOLA section 5(c)(2)(A).

These commenters also agreed that by removing this aggregation requirement federal thrifts will be afforded modest additional flexibility to expand their commercial lending. This incremental enhancement of thrifts' lending authority will benefit both thrifts and their customers, without endangering safety and soundness or thrifts' primary mission of providing mortgage lending.

One bank trade association commenter did express a concern that removing the requirement to aggregate commercial loans made by a service corporation with its parent's loans might circumvent the HOLA ceiling on commercial loans. However, the HOLA does not require that a service corporation's commercial loans be aggregated with its parent's loans for purposes of statutory percentage-of-assets limitations on general investment authority. Service corporations do not fall within the definition of savings association for purposes of applying HOLA's investments limits. As noted above, the HOLA imposes an aggregate limit on investments in service corporations of 3 percent of assets, but does not impose sublimits on service corporation investments. The FHLBB's original inclusion of a service corporation's commercial loans within its parent savings association's commercial lending authority was done in 1983 when commercial lending was a new activity for savings associations. Given the levels of capital now required for such loans and OTS's experience in regulating this activity, OTS believes that allowing this modest increase in commercial lending authority is appropriate. OTS therefore will follow the plain statutory language of HOLA sections 5(c)(2)(A) and 5(c)(4)(B), which do not require aggregation of a service corporation's commercial loans with those made by its parent.

#### *Section 545.47 Overdraft Loans*

OTS proposed to delete § 545.47, because it simply reiterated the HOLA's grant of authority to federal thrifts to make loans specifically related to transaction accounts, including overdraft loans. OTS also proposed to incorporate the reference to federal thrifts' statutory authority to make overdraft loans into the lending and investment powers chart accompanied

the parent savings association. This final rule does not affect those regulatory provisions.

by an endnote specifying that commercial overdraft loans formerly covered by § 545.46 remain subject to the same commercial lending limits. OTS received no comment on these proposed changes, which are adopted as proposed.

#### *Section 545.48 Letters of Credit*

Section 545.48 authorized federal thrifts to issue letters of credit in conformance with the Uniform Commercial Code or the Uniform Customs and Practices for Documentary Credits and subject to certain general standards. As already discussed, the HOLA expressly authorizes federal thrifts to invest in or make loans, and this express authorization to make loans necessarily includes within it the authority to make loan commitments and issue letters of credit. For ease of reference, OTS proposed to reference the authority of federal thrifts to issue letters of credit in the lending and investment powers chart. OTS also proposed to incorporate the substance of § 545.48(a) into new § 560.120 as prudent standards for the issuance of letters of credit. OTS solicited comment on whether transferring the substance of § 545.48(a) to the new Part 560 would provide needed uniform standards for all savings associations.

The two commenters to address this section both supported OTS's efforts to update § 545.48 to reflect current market standards and industry usage for letters of credit. Both commenters also supported OTS's adoption of regulatory requirements for the issuance of letters of credit for all savings associations in order to provide uniform standards for all thrifts. While applauding OTS's efforts to modernize its letters of credit regulation, however, one commenter contended that the specific language of the proposed rule was not crafted to address some of the regulatory issues raised by contemporary letters of credit practice. This commenter suggested that OTS review the most recent interpretive ruling on letters of credit issued by the OCC, which was published after OTS issued its notice of proposed rulemaking.<sup>22</sup>

Having reviewed the OCC's interpretive ruling, OTS has determined to substantially adopt the approach taken by the OCC with respect to the regulation of letters of credit. OTS believes that the OCC ruling incorporates many of the modern market standards and industry usage

applicable to letters of credit. Furthermore, by substantially adopting the OCC's approach, OTS is acting consistent with Section 303 of the CDRIA, which encourages the federal banking agencies to move towards greater uniformity in regulations on common supervisory issues.

In its February 9, 1996 ruling, the OCC treats letters of credit and independent undertakings as equivalent transactions for regulatory purposes. The OCC uses the term "independent undertakings" to encompass letters of credit as well as all such unilateral commitments under which a bank's obligation to honor its commitment is dependent solely on the proper presentation of specified documents regardless of extrinsic factors (except fraud, forgery, or an overriding public policy issue).<sup>23</sup> As the OCC points out, the term "independent undertakings" is used by the United Nations Commission on International Trade Law to cover a broad array of transactions including commercial letters of credit, standby letters of credit, and other undertakings that are functionally identical or equivalent to letters of credit.<sup>24</sup>

The new § 560.120 states that a thrift may issue and commit to issue letters of credit. The new section also allows thrifts to issue and commit to other independent undertakings approved by OTS. OTS also believes that, in the thrift context, the broad scope of the term "independent undertaking" and its recent evolution require closer supervision of such transactions when they fall outside the more traditional activities generally known as letters of credit. National banks have traditionally been more involved in international banking transactions and may be more familiar than most thrifts with nontraditional activities that fall within the term "independent undertakings". OTS believes that allowing thrifts to issue independent undertakings of a type specifically approved by OTS strikes the appropriate balance between giving thrifts greater flexibility to potentially engage in new types of transactions while at the same time ensuring that thrifts have properly evaluated the risks posed by a particular transaction consistent with prudent banking practice. OTS anticipates that its approval may take the form of legal opinions, general guidance, or case-by-case approvals, depending upon how the undertakings are presented to the agency.

<sup>22</sup> See Interpretive Ruling: Independent Undertakings To Pay Against Documents (12 CFR 7.1016) (61 FR 4849, 4852-3, 4865, February 9, 1996, effective April 1, 1996).

<sup>23</sup> See Notice of Proposed Rulemaking: Interpretive Rulings, 60 FR 11924, 11926 (March 3, 1995).

<sup>24</sup> 61 FR at 4852.

Paragraph (a) of the new § 560.120 explains that a savings association may issue and commit to issue a letter of credit or other approved independent undertaking. Paragraph (a) also provides a non-exclusive list of sample laws and rules of practice<sup>25</sup> and explains that non-documentary conditions on the thrift's undertaking are not relevant to the thrift's obligation to honor its commitment.

Paragraph (b) of the final rule requires that thrifts evaluate certain safety and soundness factors when issuing letters of credit and approved independent undertakings. Paragraph (b) also requires that thrifts possess the operational expertise commensurate with the sophistication of their letter of credit and independent undertaking activities. The final rule also permits a thrift to issue a letter of credit or other approved undertaking without an express expiration date, provided that the thrift retains the right not to renew the transaction and to cancel the transaction upon notice to the parties.

OTS also proposed to delete paragraph (b) of § 545.48, which addressed the treatment of funds advanced under a letter of credit without compensation from the account party, because it duplicates § 545.31(b), which OTS proposes to incorporate into § 560.31(a). OTS received no comment on this proposed deletion, which is adopted as proposed.

Because issuing a letter of credit is not in and of itself a loan or investment, the reference to letters of credit has been removed from the lending and investment powers chart. When a savings association advances funds under the terms of a letter of credit or independent undertaking, those funds will then constitute a loan and will be counted toward the appropriate HOLA section 5(c) investment category.

#### *Section 545.49 Loans on Securities*

OTS proposed to delete § 545.49, which simply reiterated the HOLA's grant of authority to federal thrifts to invest in loans to financial institutions and brokers secured by obligations backed by the United States government or certain agencies or instrumentalities thereof.<sup>26</sup> OTS also proposed to incorporate a reference to thrifts' statutory authority to invest in such loans secured by U.S. government or agency-backed obligations into the lending and investment powers chart. The agency also proposed to remove as unnecessary the introductory paragraph limiting permissible investments in

agencies or instrumentalities of the United States to those entities named in § 566.1(g)(3). OTS received no comments on this section and accordingly deletes this section as proposed.

#### *Section 545.50 Consumer Loans*

Section 545.50 reiterates the HOLA's grant of authority to federal thrifts to make consumer loans subject to a 35 percent of assets limit.<sup>27</sup> For purposes of determining compliance with this limit, federal thrifts must aggregate their consumer loans with any investments in corporate debt securities and commercial paper.<sup>28</sup> In other words, a federal thrift's aggregate investments in consumer loans, corporate debt securities, and commercial paper may not exceed 35 percent of its assets.

OTS proposed to delete paragraph (a) of § 545.50 and to incorporate the reference to federal thrifts' statutory authority to make consumer loans, subject to the statutory asset limit, into the lending and investment powers chart. OTS also proposed to include an endnote incorporating the provisions of paragraph (c) of § 545.50, which addressed loans to dealers in consumer goods. Commenters were generally supportive of these changes and OTS is making the proposed changes.

OTS also solicited comment on how the definition of consumer loan set forth in paragraph (b) of § 545.50 could be clarified and coordinated with other OTS regulations that address consumer credit. Several commenters pointed out the inconsistency between paragraph (b)'s definition of "consumer loan," which expressly excludes credit cards, and § 561.12, which defines "consumer credit" to include credit cards. OTS recognizes the ambiguity that arises from the use of these similar, but not identical, terms in different regulatory provisions. For purposes of HOLA investment limits and Part 560, the term "consumer loan" will continue to be defined in the Definitions section, new § 560.3, as it has been in § 545.50. As part of a later Regulatory Structure rulemaking, OTS will consider how best to minimize or eliminate the potential for confusion presented by differing definitions of similar terms.

Under current OTS regulations, credit card loans are not subject to the 35 percent of assets investment limit applicable to consumer loans, corporate debt securities, and commercial paper. Section 545.51, discussed below, governs credit card activity of federal savings associations and imposes no

percentage of assets limits on credit cards. This approach mirrors the HOLA. HOLA section 5(b)(4) authorizes federal thrifts to invest in consumer loans, corporate debt securities, and commercial paper subject to a 35 percent of assets limit is separate from the statutory provision that authorizes thrifts to invest in credit cards. The statutory provision authorizing credit cards contains no percentage of assets limit. The legislative history does not provide any clear guidance regarding whether any linkage was intended. The sole commenter addressing this issue agreed with OTS's position that the plain language of the HOLA imposes no percentage of assets limit on credit card operations.

The final rule carries forward the structure of OTS's existing regulations. Under the final rule, "consumer loan" will continue to be defined in a manner that excludes credit card loans. Thus, credit card loans are not subject to the 35 percent of assets limit on consumer loans. However, the regulation notes, at endnote 5 to § 560.30, that OTS may impose a case-by-case limit on this or any type of lending activity if the association's concentration in such investments presents a safety and soundness concern.

#### *Section 545.51 Credit Cards*

OTS proposed to delete paragraph (a) of § 545.51, which reiterated the HOLA's grant of statutory authority to federal thrifts to engage in credit card operations.<sup>29</sup> OTS proposed to incorporate a reference to federal savings associations' statutory authority to engage in credit card operations into the lending and investment powers chart. OTS received no comments on this paragraph and adopts these changes as proposed.

OTS also proposed to delete paragraph (b) of § 545.51, which addressed the confidentiality of personal security identifiers in conjunction with credit card operations, because it is redundant with the provisions of the Electronic Funds Transfer Act and Regulation E.<sup>30</sup> The one commenter addressing this paragraph supported this reasoning. OTS is deleting this paragraph as proposed.

#### *Section 545.52 Loans on Savings Accounts*

OTS proposed to delete § 545.52, which reiterated the HOLA's grant of authority to federal thrifts to make loans

<sup>25</sup> See footnote to the new § 560.120(a).

<sup>26</sup> 12 U.S.C. 1464(c)(1)(L).

<sup>27</sup> 12 U.S.C. 1464(c)(2)(D).

<sup>28</sup> *Id.*

<sup>29</sup> 12 U.S.C. 1464(b)(4).

<sup>30</sup> See 15 U.S.C. 1693 *et seq.* and 12 CFR Part 205 respectively.

on the security of savings accounts and sets forth regulatory limits on such loans.<sup>31</sup> OTS proposed to incorporate the reference to federal thrifts' statutory authority to make loans on savings accounts into the lending and investment powers chart and retain the limitation on such loans to the withdrawal amount of the savings account as an endnote to the chart. OTS received no comments on this section and the proposed changes to § 545.52 are adopted as proposed.

#### *Section 545.53 Finance Leasing*

Paragraph (a) of § 545.53 authorized federal thrifts to engage in various leasing activities that are the functional equivalent of lending, subject to certain regulatory limitations.<sup>32</sup> OTS proposed to reference federal thrifts' finance leasing authority in the proposed lending and investment powers chart, with an endnote cross-referencing applicable regulatory limitations. OTS received no comment on this proposed change, which is adopted as proposed.

OTS also proposed to consolidate the finance leasing requirements of § 545.53 with the general leasing requirements of § 545.78 into one streamlined section, new § 560.41. In connection with this consolidation, OTS proposed to delete the term limits for finance leases and to increase the minimum residual value requirement for finance leases from 20 to 25 percent. The one commenter addressing these proposed changes supported the proposed consolidation and agreed with OTS's reasoning that institutions should be free to establish their own term limits based on prudent underwriting criteria and market conditions. The commenter also supported the increase in residual value requirement because it enhanced the flexibility of thrifts' leasing operations. Because of the complexity of leasing activities, this commenter also suggested that OTS provide clear underwriting guidance for various types of leasing activities in the Handbook as well as additional examiner training on leasing arrangements. A second commenter requested a clearer definition of "full-payout lease" in § 560.41(c).

In this final rule, OTS is consolidating its leasing regulations into the newly adopted § 560.41. The section has been revised to clarify its scope and definitions. OTS is also eliminating the term limits and increasing the minimum residual value requirement for finance

leases to 25 percent. OTS notes that the OCC allows national banks to make finance leases with a residual value of 25 percent of the original cost of the property to the lessor.<sup>33</sup> OTS plans to add underwriting guidance to the Handbook addressing leasing arrangements.

OTS is also consolidating the salvage powers provisions in § 545.53 into the new § 560.41. Paragraph (e) of that new section outlines a thrift's salvage powers on all types of leases.

#### *Section 545.72 Government Obligations*

Section 545.72 reiterated the HOLA's grant of authority to federal thrifts to invest in obligations of any state, territory, or political subdivision thereof.<sup>34</sup> OTS proposed to delete this section and incorporate the reference to federal thrifts' statutory authority to invest in government obligations into the lending and investment powers chart. OTS also proposed incorporating the provisions of § 545.72(a) regarding investments in obligations meeting investment grade requirements into a new § 560.42 entitled "State and local government obligations." The lending and investment powers chart would cite the new § 560.42 in its endnotes. OTS received no comments on these proposed changes, which are adopted as proposed.

In order to encourage additional sound community-related investments, OTS also proposed modifying regulatory restrictions in § 545.72(b) before their incorporation into the new § 560.42. OTS proposed to clarify that the 1 percent of assets limitation for investments in obligations of a state or political subdivision where a savings association has its home or a branch office that do not meet the rating or full faith and credit requirements of § 545.72(a) is an aggregate limit. However, OTS also proposed to allow savings associations to invest additional amounts in such obligations, without geographic restrictions, if the obligation is specifically approved for investment by OTS.

The two commenters addressing this section supported OTS's reasoning that this change would afford savings associations additional flexibility to invest in government obligations without any threat to the associations' safety and soundness. One commenter noted that the obligations of local municipalities often are rated

noninvestment grade or are unrated, yet these communities could benefit from local savings associations' increased investment in municipal bonds. Both commenters believed that thrifts with strong capital, sound underwriting standards, and broadly diversified investment portfolios should have the discretion to invest in government obligations. One commenter argued that OTS should not require prior approval before an association is permitted to invest in government obligations in a locality in which the association does not have a home or branch office. OTS, however, believes that such prior approval is appropriate because the purchase of noninvestment grade or unrated obligations is potentially risky, and associations should be prepared to demonstrate that their decision to invest in such obligations does not pose any threat to the association's safety or soundness.

OTS believes that the proposed changes will give savings associations additional flexibility while still allowing the agency to monitor the risks presented by investments in government obligations. The proposed rule gives thrifts the option to invest in unrated government securities, exceed the 1 percent of assets limit for unrated securities of localities where the thrift has an office, or invest in obligations in localities where they do not have an office if the thrifts obtain prior OTS approval. Accordingly, OTS adopts the proposed modifications to paragraphs (a) and (b) of § 545.72 and incorporates those modified provisions into the new § 560.42.

OTS also proposed to remove the restriction on gold-related obligations contained in paragraph (c) of § 545.72 as obsolete. OTS received no comment on the proposed deletion, which is adopted as proposed.

#### *Section 545.73 Inter-American Savings and Loan Bank*

Section 545.73 reiterated federal savings associations' authority to invest in the share capital and capital reserve of the Inter-American Savings and Loan Bank, subject to statutory and regulatory limitations on the amount of investment.<sup>35</sup> OTS proposed to remove this section and incorporate this authority and limitations into the new lending and investment powers chart, endnotes, and new § 560.43, which addresses foreign assistance investments. OTS received no comment on these proposed changes, which are adopted as proposed.

<sup>31</sup> 12 U.S.C. 1464(c)(1)(A).

<sup>32</sup> Section 545.53 cited several HOLA lending provisions, 12 U.S.C. 1464 (c)(1)(B), (c)(2)(A), and (c)(2)(D), as the basis for federal thrifts' finance leasing authority.

<sup>33</sup> The OCC has recently proposed amendments to its leasing regulation at 60 FR 46246 (September 6, 1995).

<sup>34</sup> 12 U.S.C. 1464(c)(1)(H).

<sup>35</sup> 12 U.S.C. 1464(c)(4)(C).

*Section 545.74 Service Corporations*

OTS proposed, as discussed under § 545.46 above, to no longer aggregate commercial loans made by a savings association's service corporation with commercial loans made by the savings association itself for purposes of the statutory 10 percent of assets limitation. The agency proposed a conforming change to § 545.74(c)(1)(vi), where this regulatory aggregation is repeated. The remaining provisions of § 545.74 are currently under separate review as part of the agency's reinvention of its subsidiaries regulations.<sup>36</sup> The one commenter specifically addressing the conforming change to § 545.74 supported excluding any commercial loan booked by a service corporation from the 10 percent commercial loan limit for federal savings associations. The commenter noted, as did the OTS proposal, that this modification would make the treatment of commercial loans owned by service corporations consistent with the treatment of noncommercial loans owned by service corporations. Accordingly, OTS has modified this paragraph as proposed.

*Section 545.75 Commercial Paper and Corporate Debt Securities*

Section 545.75(a) reiterated the HOLA's grant of authority to federal thrifts to invest in commercial paper and corporate debt securities.<sup>37</sup> OTS proposed to delete this paragraph and to reference federal thrifts' statutory authority to invest in commercial paper and corporate debt securities in the lending and investment powers chart. The agency also proposed to retain the limitations on these investments contained in paragraphs (b) and (c) and to move them into the new § 560.40 on commercial paper and corporate debt securities in Part 560.<sup>38</sup>

The only commenter to address this section questioned why paragraph (b) requires a thrift's investments in commercial paper and corporate debt securities to be denominated in dollars. OTS agrees with this commenter's position that the HOLA, 12 U.S.C. 1464(c)(2)(D), does not require such denomination, and previous OTS opinions have stated that such investments are permissible as long as foreign currency risks are properly hedged. Accordingly, OTS adopts § 560.40 as proposed with the

modification that commercial paper and corporate debt securities are no longer required to be denominated in dollars.

OTS also proposed to delete paragraph (d) of § 545.75 as no longer having any practical application for thrifts in light of § 28(d) of the Federal Deposit Insurance Act<sup>39</sup> (FDIA). Paragraph (d) authorized a federal savings association to invest in commercial paper and corporate debt securities not meeting the rating and marketability requirements of paragraphs (b) and (c), so long as such investments are not otherwise prohibited by § 28(d) of the FDIA, which prohibits investments by thrifts in unrated corporate bonds. Although OTS solicited comment as to whether there was any scenario under which an investment authorized by paragraph (d) would not violate § 28(d) of the FDIA, OTS received no responsive comments. Because OTS believes that paragraph (d) has no practical application for thrifts, it is deleting paragraph (d) as proposed.

*Section 545.78 Leasing*

Paragraph (a) of § 545.78 reiterated the HOLA's grant of authority to federal thrifts to invest in tangible personal property for leasing purposes.<sup>40</sup> OTS proposed to incorporate a reference to this statutory authority into the proposed lending and investment powers chart. As already discussed under § 545.53 earlier, OTS also proposed to consolidate the general leasing restrictions applicable to federal savings associations in § 545.78 with the finance leasing restrictions in § 545.53 into a new § 560.41. The one commenter addressing these proposed changes supported the consolidation, and OTS is adopting these changes as proposed.

OTS also proposed to delete paragraph (b) of § 545.78, which imposes a maximum 70 percent residual value limit for general leasing activities. OTS believes that such an underwriting restriction may be unduly restrictive if applied in all cases and that such lease underwriting considerations are better addressed within each association's prudent leasing policies, which will be subject to review by OTS examiners. Furthermore, OTS plans to provide underwriting guidance on leases in its Handbook. The one commenter addressing this section supported the proposed deletion because it would give additional flexibility to thrifts in structuring lease arrangements. The commenter also suggested that additional underwriting guidance be

included in the Handbook because of the complexity of leasing activities.

OTS is deleting the maximum 70 percent residual value limit as proposed and replacing that requirement with more flexible underwriting guidance in the Handbook. As discussed earlier under § 545.53, the new § 560.41 addresses both general leasing and finance leasing authority.

*Section 556.2 Power To Engage in Escrow Business*

Section 556.2 addressed federal thrifts' power to engage in the escrow business. OTS proposed to delete this policy statement, because OTS believes that the authority to establish escrow accounts is subsumed within the authority of federal savings associations to make loans and does not need to be specifically identified in the CFR. See discussion above with regard to § 545.32(b)(6). Although one commenter supported the proposed elimination of this section as unnecessary, a second commenter raised a concern that elimination of this section might raise preemption concerns. For the reasons discussed above with regard to § 545.32(b)(6), OTS believes that a thrift's power to establish escrow accounts does not need to be specifically identified in the CFR. Furthermore the new preemption regulation at § 560.2 specifically cites escrow accounts as an area in which state law is preempted. Accordingly, OTS is deleting § 556.2, as proposed.

*Section 556.3 Real Estate*

Section 556.3(a) addressed the treatment of motels as either improved nonresidential real estate or combination home and business property for real estate categorization purposes. OTS proposed to delete this paragraph and incorporate it into guidance. Section 556.3(b) permitted federal thrifts to purchase paving certificates that constitute a lien on property securing an association's loan. OTS proposed to delete this section and transfer the language of the policy statement to the Handbook. OTS received no comment on these proposed deletions, which are adopted as proposed.

*Section 556.10 First Liens on Properties Sold by the Secretary of HUD*

Section 556.10 reiterated federal thrifts' authority to make mortgage loans insured by the Federal Housing Administration and secured by first liens on improved real estate and discussed the treatment and documentary evidence of such loans after disposal by the Secretary of

<sup>36</sup> See Notice of Proposed Rulemaking, Subsidiaries and Equity Investments, 61 FR 29976 (June 13, 1996).

<sup>37</sup> 12 U.S.C. 1464(c)(2)(D).

<sup>38</sup> The agency also solicited comment on whether these provisions should, alternatively, be removed from the regulations and incorporated as guidance in the Handbook.

<sup>39</sup> 12 U.S.C. 1831e(d).

<sup>40</sup> 12 U.S.C. 1464(c)(2)(C).

Housing and Urban Development. OTS proposed to delete this policy statement and move it to guidance in the Handbook. OTS received no comment on this proposed deletion, which is adopted as proposed.

#### *Section 563.93 Lending Limitations*

Section 563.93 contained lending limits on all loans and extensions of credit made by all savings associations and their subsidiaries. This section and its accompanying Appendix are being redesignated and moved unchanged into new Part 560 as § 560.93, for ease of reference.

#### *Section 563.95 Investment in State Housing Corporations*

Section 563.95 covered investments in or loans to state housing corporations by all savings associations. It imposed certain conditions, including percentage-of-asset limitations, depending on the type of loan or investment and the savings association's capital level. OTS proposed to modify and update this section and move it into a new § 560.121 in new Part 560.

Paragraph (a) dealt with loans to, and investments in obligations of, state housing corporations that are secured, directly or indirectly, by first liens on federally insured improved real estate. OTS proposed to remove percentage-of-asset investment limitations in this paragraph (a). Commenters supported OTS's reasoning that removing the percentage-of-assets limit would allow thrifts to exercise business judgment in determining the amount they wished to invest in such loans and obligations, subject, as always, to overall safety and soundness considerations.

OTS proposed to update the language in paragraph (b), which covers investments in obligations of state housing corporations that do not fall under paragraph (a), in several ways. First, the agency proposed to remove the outdated limitation based on a thrift's level of "general reserves surplus and undivided profits." Instead, any thrift that is adequately capitalized under 12 CFR Part 565 may make such investments. Second, OTS proposed to allow investments under paragraph (b) to be made in obligations of state housing corporations located in any state in which the association has its home or a branch office. Third, OTS proposed to revise the aggregate limit on such investments to equal a thrift's total capital under 12 CFR Part 567 (rather than its general reserves, surplus, and undivided profits) and to move this requirement into a new paragraph (b)(2). Finally, the agency proposed to delete the requirement that a thrift may make

no more than 25 percent of its aggregate investment in this type of obligation in the obligations of any one state housing corporation. This requirement effectively required an institution to invest in four state housing corporations any time it wished to invest in one.

Commenters believed that revisions to restrictions on investments in state housing corporations would encourage institutions to make additional sound community related investments. Savings associations' increased participation in community-related investments could potentially benefit communities and their affordable housing programs without undermining thrifts' safety and soundness. Commenters also agreed that elimination of the 25 percent limit on investments to a single state housing corporation should cause no problem because thrifts will be protected by the cap on aggregate investments and by examiners' asset concentration review. One commenter urged OTS to go further and make additional revisions, such as allowing thrifts to invest in obligations of state housing corporations throughout the country, not just where the thrift has a home or branch office. This commenter also suggested removing the aggregate cap on total investments, subject to OTS approval, under certain circumstances. OTS, however, believes that the proposed regulatory language strikes the appropriate balance between giving thrifts additional flexibility with respect to investment in state housing corporations and ensuring safe and sound operations. Accordingly, OTS adopts the proposed revisions to paragraphs (a) and (b) of § 563.95 and incorporates those revisions into the new § 560.121.

The agency also proposed to delete existing paragraph (c), which allows thrifts (that otherwise have the legal authority to do so) to make direct equity investments in equity securities of state housing authorities. Federal thrifts currently do not have authority to invest in equity securities of state housing corporations, and section 28 of the FDIA constrains state chartered thrifts from making, or retaining past July 1, 1994, any equity investment not permissible for federal thrifts.<sup>41</sup> Although OTS solicited comment as to whether there was any scenario under which paragraph (c) was still relevant, no commenters responded to this request.

<sup>41</sup> See 12 U.S.C. 1831e(c), which states that a state chartered savings association "may not directly acquire or retain any equity investment of a type or in an amount that is not permissible for a Federal savings association," with a limited exception for service corporation investments.

OTS deletes paragraph (c) of § 563.95 as proposed.

The agency proposed to move paragraph (d), substantially unchanged, into new § 560.121 as paragraph (c). This paragraph addresses a thrift's obligation, before making an investment in a state housing corporation, to obtain the corporation's agreement to make information available to OTS upon request. OTS received no comment on this provision which is adopted as proposed.

#### *Section 563.97 Loans in Excess of 90 Percent of Value*

OTS proposed to delete § 563.97, which authorized thrifts to make loans on the security of residential real estate with loan-to-value ratios in excess of 90 percent of value, consistent with the interagency real estate lending standards. Commenters agreed that the interagency real estate lending standards address the same issue in a more comprehensive manner. OTS is deleting § 563.97 as proposed.

#### *Section 563.99 Fixed-Rate and Adjustable-Rate Mortgage Loan Disclosures, Adjustment Notices, and Interest Rate Caps*

Section 563.99 defined fixed and adjustable-rate mortgage loans and required thrifts to make certain disclosures to applicants of adjustable-rate mortgage loans. In order to establish parity in coverage with other lenders, OTS proposed to add a new paragraph (g) to exclude from § 563.99's coverage adjustable-rate loans that are primarily for a business, commercial, or agricultural purpose, consistent with the Federal Reserve Board's (FRB) Truth in Lending regulation, Regulation Z.<sup>42</sup>

Commenters generally favored making § 563.99's coverage consistent with that of Regulation Z. Section 563.99 covered all adjustable-rate loans with a term of more than one year, secured by property occupied or to be occupied by the borrower. Unlike § 563.99, Regulation Z's coverage is not determined by the nature of the secured property but rather by other criteria, e.g., the extension of credit must be primarily for personal, family, or household purposes.<sup>43</sup> As the regulations interacted, certain transactions were encompassed by § 563.99 but not by Regulation Z. By adopting the proposed changes to § 563.99, OTS will be minimizing the differences between that section and Regulation Z. For example, a savings

<sup>42</sup> Regulation Z exempts from its disclosure requirements extensions of credit primarily for business, commercial, or agricultural purposes. See 12 CFR 226.3(a)(1).

<sup>43</sup> 12 CFR 226.1(c)(1)(iv).

association that makes a business purpose ARM loan secured by a home will no longer be subject to the disclosure requirements set forth at § 563.99; nor would any disclosures be required under Regulation Z.

Several commenters recommended deleting the disclosure portions of § 563.99 in their entirety because those provisions were duplicative of Regulation Z. Commenters argued that two sets of disclosure regulations confused lenders and required them to search two places to figure out applicable regulatory requirements. OTS will undertake a comprehensive review of § 563.99 in conjunction with the FRB's review of Regulation Z pursuant to section 303 of the CDRIA.<sup>44</sup> Pending that review, § 563.99 is being redesignated as § 560.210, so that all lending regulations will be grouped together in Part 560. The only changes being made to § 563.99 are changing its title to be more descriptive of its content, adding a new paragraph (g), as discussed above, and removing paragraph (a)(2), which defined "fixed rate mortgage loan," a term not used in the regulation. OTS does note that the disclosure requirements of current § 563.99 and Regulation Z<sup>45</sup> are substantially similar.

#### *Section 563.100–563.101 Real Estate Lending Standards*

These sections prescribed real estate lending standards that require all savings associations to adopt and maintain comprehensive written real estate lending policies that are consistent with safe and sound practices and with the Guidelines for Real Estate Lending.<sup>46</sup> Savings associations' policies must address certain lending considerations including loan-to-value limits, loan administration procedures, portfolio diversification standards, and documentation, approval, and reporting requirements. OTS did not propose changes to these sections, but indicated its intent to redesignate and move them substantially unchanged into a new Part 560. OTS received no comment on these proposed redesignations and is redesignating them as §§ 560.100–560.101 in the final rule issued today.

<sup>44</sup> Pursuant to section 303(b) of the CDRIA, the FRB is required to review its regulations with respect to disclosures pursuant to the Truth In Lending Act with regard to adjustable-rate mortgages in order to simplify the disclosures, if necessary, and make the disclosures more meaningful and comprehensible to consumers. 12 U.S.C. 4803.

<sup>45</sup> See 12 CFR 226.19(b), 226.20(c).

<sup>46</sup> Appendix A to the real estate lending standards at current §§ 563.100–101.

The Appendix containing the guidelines is also being redesignated.

#### *Section 563.160 Classification of Certain Assets*

Section 563.160 required thrifts to classify their own assets and establish valuation allowances. OTS proposed to delete this section in its entirety.<sup>47</sup> The one commenter addressing this section favored its deletion and suggested placing classification guidance in the Handbook. This commenter noted that the section's deletion would be consistent with the stance of the other banking agencies which set forth their asset classification systems as supervisory guidance, not as regulations.

Upon further consideration, OTS has decided to retain a short classification regulation simply stating that a savings association must have an internal system to classify assets and must establish appropriate valuation allowances or charge-offs, as appropriate. OTS believes that retaining a short classification regulation at new § 560.160 will ensure that a thrift's board of directors takes responsibility for monitoring its classification system. OTS will transfer more detailed guidance concerning asset classification to the Handbook consistent with the supervisory guidance of the other federal banking agencies.

#### *Section 563.170 Examinations and Audits; Appraisals; Establishment and Maintenance of Records*

Paragraph (a) of § 563.170 authorizes OTS to examine thrifts consistent with OTS policies and to annually assess thrifts for the costs of such examinations based on the thrifts' assets. OTS proposed to retain this paragraph. The agency received no comment on this section, which is retained as proposed in its current location.

Paragraph (b) authorizes OTS to select appraisers to perform appraisals of real estate in connection with examinations and audits and requires thrifts to pay for such appraisal services. OTS proposed to retain this paragraph. The agency received no comment on this section, which is also retained as proposed.

Paragraph (c) sets forth general record maintenance requirements for savings associations to ensure that examiners

<sup>47</sup> OTS had already requested comment on deleting the definitions of "Substandard," "Doubtful," and "Loss" set forth in paragraph (b) and the definition of "Special Mention" assets in paragraph (e) because definitions of those terms are contained in the Handbook. 58 FR 38730 (July 20, 1993). Commenters supported such deletions. The OTS proposed deleting paragraph (f) as part of its regulatory review proposal, 60 FR 44442 (August 28, 1995), and received no unfavorable comments.

have access to an accurate and complete record of all business transacted by the thrift. OTS proposed to retain this general introductory paragraph, with a modification to incorporate language in current paragraph (c)(9) on maintaining records required by other laws or regulations.

Paragraphs (c) (1)–(9), however, set forth a list of specific loan documents that, at a minimum, thrifts must maintain to comply with § 563.170(c). OTS proposed replacing the specific documentation requirements listed in paragraphs (c) (1)–(9) with more general documentation standards in a new § 560.170 in Part 560. These proposed standards were drawn from the interagency Standards for Safety and Soundness regulations and attached Guidelines Establishing Standards for Safety and Soundness.<sup>48</sup> These guidelines set forth loan documentation and credit underwriting requirements to which all federal insured depository institutions are expected to adhere. These underwriting and documentation standards minimize the need for OTS to have a regulation mandating specific documentation requirements.<sup>49</sup>

Commenters unanimously supported OTS's proposal to eliminate the detailed list of documents required in paragraphs (c) (1)–(9). Commenters agreed with OTS's reasoning that although the documents listed were generally appropriate for prudent lending, a rigid requirement that all documents be present for each loan was too restrictive and did not necessarily address all safety and soundness concerns. Commenters believed that elimination of the specific document list would give lenders more flexibility to tailor loan documentation to various types of loans and to determine which particular documents would be most appropriate for a specific loan.

For example, previously § 563.170(c)(1)(v) required either a financial statement or a credit report for all loans, ostensibly to justify the borrower's willingness and ability to repay the loan. However, the ability and willingness of a borrower to repay a consumer or home loan may be better demonstrated with a verification of employment (not previously required) and a satisfactory credit report, rather than a financial statement. For commercial borrowers, verification by

<sup>48</sup> 12 CFR Part 570 and Appendix A thereto, 60 FR 35674 (July 10, 1995).

<sup>49</sup> Guidelines appended to the interagency real estate lending standards also state that an institution should establish loan administration procedures that address documentation. See 12 CFR Part 563, Subpart D, Appendix A (redesignated in this rulemaking as Appendix to § 560.101).

the institution that the borrower's financial statements accurately reflect all assets, liabilities, and any other guarantees or encumbrances is more important to the decision to extend credit than the mere presence of a financial statement. The more flexible language of new § 560.170 will allow thrifts to obtain documentation that best satisfies safety and soundness concerns raised in a particular transaction, while at the same time relieving thrifts of the burden of technical compliance with a document checklist that may not necessarily be relevant to prudent lending.

Commenters also agreed that deleting paragraphs (c) (1)–(9) would relieve savings associations of documentation requirements that exceed those for banks and other financial institutions as well as enable savings associations to take better advantage of technological marketplace advances such as telephone and computerized home banking. New § 560.170 will allow savings associations to participate in telephone and computerized home banking without running afoul of paper driven-requirements. Accordingly OTS adopts the changes to § 563.170(c) as proposed.

In its proposal, OTS also considered transferring the current document list in paragraphs (c) (1)–(5), and (7) to the Handbook to be used as a checklist of records generally maintained by prudent lenders to support a loan. Several commenters raised concerns regarding the language of the guidance that would be included in the Handbook. One commenter urged that if OTS includes a document list in the Handbook, the agency should also clearly state that the list is intended only as guidance and not as rigid minimum requirements for safety and soundness. The commenter suggested inserting language to the effect that the lender (based on borrower creditworthiness, the specific program and product offering, pricing, project delinquency, loss profile, and title and appraisal information) should have the discretion not to require certain documents in any given situation. Another commenter recommended deletion of the requirement that loan documents identify a purpose for the loan because lines of credit are now used for any purpose, the identification of which is not necessary to proper underwriting. The interagency guidelines establishing standards for safety and soundness do state that a lender should identify the purpose of a loan.<sup>50</sup> However, OTS will review these comments prior to issuing any loan

documentation guidance to be included in the Handbook.

Paragraph (c)(10) of § 563.170 exempted certain small business loans from the documentation requirements set forth in paragraphs (c) (1)–(7). OTS proposed to delete paragraph (c)(10) inasmuch as the streamlining of the requirements currently located in paragraphs (c) (1)–(7) eliminates the need for this exemption. OTS received no comment on this paragraph, which is deleted as proposed.

OTS proposed to retain paragraph (d) of § 563.170, which addresses changes in the location of accounting or control records. One commenter questioned whether advances in computer technology rendered this paragraph obsolete since computerized accounting and control records could be accessed at many locations. Although OTS recognizes that computerized records may be read from computer terminals in many locations, OTS believes that the agency may need to know the location of the server where computer records are physically stored for examination purposes. Accordingly, OTS is retaining this paragraph as proposed.

OTS proposed to retain paragraph (e), which addresses use of data processing services for maintenance of records. One commenter suggested that all but the last sentence of this paragraph could be eliminated inasmuch as maintenance of records by means of data processing services has become the norm and requiring a thrift to notify the Region in which its principal office is located of such maintenance creates unnecessary paperwork. Although OTS agrees that thrifts routinely maintain records by means of data processing services, the agency believes that this paragraph serves the purpose of requiring institutions to identify the particular records to be maintained by a data processing service and the location where such records are maintained. This information may be critical to an examination or enforcement inquiry. Accordingly, OTS is retaining this paragraph as proposed.

To summarize, § 563.170 is being modified as proposed, by removing the specific loan documentation requirements of paragraphs (c) (1) through (10) and by retaining the remainder of the regulation. The specific loan documentation requirements have been replaced by more general lending documentation requirements in new § 560.170.

#### *Section 563.172 Reevaluation of Real Estate Owned*

Section 563.172 required savings associations to appraise all real estate

owned (REO) at the earlier of in-substance foreclosure or at the time of acquisition and, thereafter, as dictated by prudent management policy. In its proposal OTS discussed deleting this section because thrifts can apply the appraisal regulations and general accounting principles (GAAP) to determine when an appraisal may be appropriate or necessary for safety and soundness. Two commenters supported elimination of this section to give lenders more flexibility with regard to the timing of an appraisal for property soon to become REO. Commenters agreed, however, that it is sound policy to require an appraisal for REO. Upon consideration, OTS has decided to retain this regulation to specify when, at a minimum, safety and soundness require an appraisal of REO. Accordingly, it is incorporating § 563.172 unchanged into the new Part 560 as new § 560.172.

#### *Section 571.8 Investment in State Housing Corporations*

Section 571.8 limited savings associations' investment authority in state housing corporations to certain public and private corporations and agencies. OTS proposed to delete this policy statement as an unnecessary limitation on the definition of state housing corporation. The one commenter to address this section supported its deletion. OTS is deleting § 571.8 as proposed.

#### *Section 571.13 Participation Interests in Pools of Loans*

Section 571.13 addressed appropriate documentation for a savings association's purchase of a participation interest in a pool of loans (in the nature of mortgage-backed securities) and indicated that compliance with the documentation requirements of § 563.170 may be impracticable for such transactions. OTS proposed to delete this section inasmuch as the proposed revision of § 563.170(c) would eliminate the need for this policy statement. OTS received no comment on this section, which is deleted as proposed. OTS plans to transfer the documentation guidance for purchases of participation interests in pools of loans to the Handbook.

#### *Section 571.20 Payment for Appraisals*

OTS proposed to delete § 571.20, which addressed payment by savings associations for appraisals obtained as part of an OTS examination. OTS received no comment on this section, which is deleted as proposed. OTS expects to transfer this policy statement to the Handbook.

<sup>50</sup> 60 FR at 35679.

*Section 571.22 Most Favored Lender Status*

Section 571.22 implemented section 4(g) of the HOLA, which authorizes savings associations to charge on any extension of credit an interest rate equal to the greater of: (a) One percentage point above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve district in which the savings association is located; or (b) the rate allowed by the laws of the State in which the savings association is located for the state's most favored lender. OTS proposed to move § 571.22 into new § 560.2(d)(1) and requested comment on whether certain provisions in § 571.22 should be modified. Because HOLA section 4(g) and this regulation apply to all savings associations, however, § 571.22 is being moved to a new § 560.110, "Most Favored Lender, Usury Preemption" in Subpart B of Part 560, which applies to all savings associations. Changes to the text of the regulation are discussed under § 560.110 below.

*2. New Part 560—Lending and Investment*

OTS proposed to adopt a new Part 560, Lending and Investment, that would ultimately include all of the agency's lending and investment regulations except for Appraisals (Part 564) and subsidiary-related investments (currently proposed to be located in new Part 559). Commenters generally agreed with OTS's view that this reorganization will make it much easier for those using the agency's regulations to find all relevant lending and investment powers, authorities, and limitations. Accordingly, OTS is adopting new Part 560 as discussed below.

*Section 560.1 General*

This section sets out the basic statutory authority for lending and indicates which regulations in this part will apply only to federal savings associations and which regulations apply to all savings associations. It also briefly sets forth the agency's expectations that all lending and investment activities are to be conducted prudently, consistent with safety and soundness, with adequate portfolio diversification, and in a manner appropriate for the size of the institution, the nature and scope of its operations, and conditions in its lending market. OTS received no comment on this section, which is adopted as proposed, with minor clarifications.

*Section 560.2 Applicability of Law*

This section sets forth OTS's longstanding position, as developed in case law and legal opinions by both OTS and its predecessor, the FHLBB, and as reflected in § 545.2, on the federal preemption of state laws affecting the lending activities of federal savings associations. Because the agency proposed to move its lending regulations out of Part 545 and, thus, separate them from its general preemption regulation, § 545.2, and because the agency proposed to remove many of the details of the lending regulations that had been previously cited in preemption opinions, OTS also proposed new § 560.2 to confirm and carry forward its existing preemption position.

It is well established that state laws can be preempted not only by federal statutes, but also by federal regulations promulgated pursuant to authority delegated by Congress.<sup>51</sup> In this regard, the Supreme Court has recognized that Congress gave the regulator of federal savings associations broad preemptive authority:

Congress enacted the HOLA [as] "a radical and comprehensive response to the inadequacies of the existing state systems \* \* \*." Thus, in section 5(a) of the [HOLA], Congress gave the [FHLBB and now the OTS] plenary authority to issue regulations \* \* \* "providing for the \* \* \* incorporation, examination, operation, and regulation of [federal savings] associations \* \* \*."

Congress directed that, in regulating federal [savings associations], the [FHLBB and OTS should] consider "the best practices of local mutual thrift and home financing institutions in the United States," which were at the time all state-chartered. By so stating, Congress plainly envisioned that federal savings [associations] would be governed by what the [FHLBB and now OTS]—not any particular state—deemed to be the best practices, and approved the [FHLBB's and OTS's] promulgation of regulations superseding state law \* \* \*.<sup>52</sup>

Consistent with the foregoing, courts have long recognized that federal savings associations organized under the HOLA are uniquely federalized financial institutions—even more so than national banks.<sup>53</sup> Prior to enactment of the HOLA, "the states had developed a hodgepodge of savings and loan laws and regulations, and Congress hoped the [the FHLBB, and now OTS] rules would set an example

for uniform and sound savings and loan regulation."'<sup>54</sup>

Thus, OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to: (i) Facilitate the safe and sound operation of federal savings associations, (ii) enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or (iii) further other purposes of the HOLA. Because lending lies at the heart of the business of a federal thrift, OTS and its predecessor, the FHLBB, have long taken the position that the federal lending laws and regulations occupy the entire field of lending regulation for federal savings associations, leaving no room for state regulation. For these purposes, the field of lending regulation has been defined to encompass all laws affecting lending by federal thrifts, except certain specified areas such as basic real property, contract, commercial, tort, and criminal law.

As a result, instead of being subject to a hodgepodge of conflicting and overlapping state lending requirements, federal thrifts are free to originate loans under a single set of uniform federal laws and regulations. This furthers both the "best practices" and safety and soundness objectives of the HOLA by enabling federal thrifts to deliver low-cost credit to the public free from undue regulatory duplication and burden. At the same time, the interests of borrowers are protected by the elaborate network of federal borrower-protection statutes applicable to federal thrifts, including the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Consumer Leasing Act, the Fair Debt Collection Practices Act, the Community Reinvestment Act, and the Federal Trade Commission Act.<sup>55</sup> In addition, in those instances

<sup>54</sup> *Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979) (citation omitted).

<sup>55</sup> Several of these statutes contain provisions that expressly disclaim any intent to preempt non-conflicting state statutes falling in the same subject area. *E.g.*, 12 U.S.C. 2616 (Real Estate Settlement Procedures Act); and 15 U.S.C. 1610 (Truth in Lending Act). The fact that one or several federal statutes do not preempt certain types of state laws, however, does not preclude the possibility that other federal statutes or regulations might do so under more defined or specific circumstances. In this regard, it is important to note that the above-referenced federal statutes that contain preemption disclaimers apply to all types of lenders (including state-chartered lenders), not just federal savings

<sup>51</sup> *Fidelity Federal Savings & Loan Association v. de la Cuesta*, 458 U.S. 141, 153–154 (1982).

<sup>52</sup> *Id.* at 160–167 (citations omitted).

<sup>53</sup> *People v. Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 319 (S.D. Cal. 1951).

where OTS has detected a gap in the federal protections provided to borrowers, the agency has promulgated regulations imposing additional consumer protection requirements on federal thrifts.<sup>56</sup>

New § 560.2 carries forward this approach to federal preemption. Although the final form of regulation is similar to what was proposed, some changes have been made in response to comments received. Several commenters expressed concern that the statement in proposed § 560.2(a) that OTS intended to occupy the entire field of lending regulation for federal thrifts would not be sufficient to restrain state regulators from asserting jurisdiction, given that OTS was also proposing to remove some of its more detailed regulatory language specifically authorizing federal thrifts to engage in various lending-related practices, *e.g.*, advertising, charging certain fees, and establishing escrow accounts. One commenter suggested that OTS expand its noninclusive illustrative list of the types of state laws preempted to reference additional laws, such as those pertaining to private mortgage insurance or other credit enhancements, loan servicing, charging application and overlimit fees, establishing impound and similar accounts, using credit reports, and setting certain interest rate ceilings. Other commenters echoed these concerns.

In response to commenters' concerns, OTS has made some changes to § 560.2.

associations. The fact that Congress did not wish to preempt the application of state laws to this general universe of lenders (including lenders chartered and regulated by the very states whose laws would be preempted), does not preclude the possibility that Congress may have elsewhere evidenced a specific intent to preempt, or permit a federal regulator to preempt, the application of state laws to a particular category of lender—in this case, federal savings associations. This is precisely the conclusion reached by the court in *First Federal Savings & Loan Association v. Greenwald*, 591 F.2d 417 (1st Cir. 1979). There, the court held that OTS's predecessor, the FHLBB, was authorized by Congress in the HOLA to preempt state lending laws even when they fall in areas covered by the preemption disclaimer in the Real Estate Settlement Procedures Act. We believe the court's holding reflects a correct understanding of the interplay between the HOLA and the above-referenced statutes, as evidenced by the legislative history of the HOLA. See, *e.g.*, 124 Cong. Rec. 33848 (Statement of Rep. Minish); 124 Cong. Rec. 36148 (1978) (colloquy between Sen. Proxmire and Sen. Brooke confirming that federal thrifts are not subject to state truth in lending requirements); 124 Cong. Rec. 33848–33849 (statement of Rep. St Germain to the same effect); and 126 Cong. Rec. 6981 (1980) (colloquy between Rep. St Germain and Rep. Patterson confirming that thrifts, unlike national banks, are not subject to state lending laws).

<sup>56</sup> See, *e.g.*, 12 CFR Part 535 (prohibited consumer credit practices) and new §§ 560.33 (late charges), 560.34 (prepayments), and 560.35 (adjustments to home loans).

Paragraph (a) still explicitly states the agency's intent to occupy the field of lending regulation for federal thrifts. However, the statutory bases and regulatory rationale for this occupation are more clearly articulated. In addition, to avoid any impression that the repeal of certain lending regulations is intended to abdicate portions of the lending field to state regulation, we have added an affirmation that, "OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation."

Paragraph (b) contains an expanded list of examples of the types of state laws that are preempted. The introductory text in paragraph (b) continues to emphasize that the list is not intended to be exhaustive. Failure to mention a particular type of state law that affects lending should *not* be deemed to constitute evidence of an intent to permit state laws of that type to apply to federal thrifts. To the contrary, § 560.2 is based on the premise that any state law that affects lending is preempted unless it clearly falls within the parameters of paragraph (c).

Paragraph (b) also continues to contain an exception clause indicating that certain state laws that would not ordinarily apply to federal savings associations may nevertheless apply when an association elects to utilize a state's most favored lender usury rate. When utilizing a state's most favored lender rate, a federal savings association must comply with all laws of its "location" state that fall within the ambit of the term "interest," as used in section 4(g) of the HOLA, as well as any other state laws "material to the determination of the interest rate." For a fuller discussion of these issues, see the description below of new § 560.110 (most favored lender).

Paragraph (c) describes certain types of state laws that OTS does not intend to preempt. Several commenters urged deletion of this paragraph. Commenters expressed concern that states seeking to avoid federal preemption of their laws or regulations might attempt to characterize those laws as falling within paragraph (c). Commenters contended that the language used to describe the categories of non-preempted laws was too broad and could create ambiguity about which state laws federal thrifts would be required to follow. For example, states might place laws purporting to regulate lending-related fees in the portions of state codes dealing with general contract or real property laws in an effort to avoid preemption.

OTS believes that paragraph (c) should be retained in order to provide guidance regarding the scope of preemption intended by paragraph (a). OTS wants to make clear that it does not intend to preempt basic state laws such as state uniform commercial codes and state laws governing real property, contracts, torts, and crimes. To reduce the potential for misunderstanding, however, we have made several changes to paragraph (c). First, we have modified the regulatory language that precedes the list of state laws that are not preempted. The introductory language now indicates that laws falling in these areas are not preempted to the extent that they either: (i) Have only an incidental impact on lending; or (ii) are otherwise not contrary to the purposes expressed in paragraph (a) of the regulation. We also have added a provision to paragraph (c) disclaiming an intent to preempt other state laws that may affect lending, but that OTS, upon review, finds further a vital state interest and meet the foregoing two-part test.

Adding this two-part test to the regulation will provide an interpretive standard for identifying state laws that may be designed to look like traditional property, contract, tort, or commercial laws, but in reality are aimed at other objectives, such as regulating the relationship between lenders and borrowers, protecting the safety and soundness of lenders, or pursuing other state policy objectives.

When confronted with interpretive questions under § 560.2, we anticipate that courts will, in accordance with well established principles of regulatory construction, look to the regulatory history of § 560.2 for guidance. In this regard, OTS wishes to make clear that the purpose of paragraph (c) is to preserve the traditional infrastructure of basic state laws that undergird commercial transactions, not to open the door to state regulation of lending by federal savings associations. When analyzing the status of state laws under § 560.2, the first step will be to determine whether the type of law in question is listed in paragraph (b). If so, the analysis will end there; the law is preempted. If the law is not covered by paragraph (b), the next question is whether the law affects lending. If it does, then, in accordance with paragraph (a), the presumption arises that the law is preempted. This presumption can be reversed only if the law can clearly be shown to fit within the confines of paragraph (c). For these purposes, paragraph (c) is intended to be interpreted narrowly. Any doubt

should be resolved in favor of preemption.

As questions arise, OTS will issue interpretive guidance consistent with the foregoing. While recognizing that no regulation can anticipate and expressly resolve all questions, we believe that new § 560.2 provides thrifts with substantially more guidance than was available under § 545.2, thereby enabling them to plan and operate their lending operations more efficiently. From time to time, OTS will review, update, and modify § 560.2 to ensure that it reflects new developments and promotes "best practices" and safety and soundness.

Paragraph (d) of proposed § 560.2 was derived from former § 571.22. It is being adopted as § 560.110, incorporating the modifications described earlier under that section.

### *Section 560.3 Definitions*

This new section has been added to set forth in Part 560 lending-related definitions formerly located in Part 545.

#### *Subpart A—Lending and Investment Powers for Federal Savings Associations*

This subpart contains lending and investment regulations directly applicable only to federal savings associations. These regulations are nonetheless relevant to state-chartered savings associations by virtue of § 28 (a) and (b) of the FDIA and the Federal Deposit Insurance Corporation's regulations at 12 CFR 303.13, which look to the type and amount of activities permissible for federal savings associations as a baseline for activities permitted for state-chartered savings associations.

### *Section 560.30 General Lending and Investment Powers*

Proposed § 560.30 took the form of a chart that listed many of the lending and investment powers granted to federal thrifts by the HOLA. It was derived from the regulations that currently appear in Part 545. An important component of this regulation are the endnotes to the chart that elaborate upon statutory limitations, impose regulatory limitations, or otherwise describe conditions on the exercise of these powers.

Commenters generally found the chart to be a very workable reference tool, particularly for percentage of assets limitations for specific types of loans and investments. Commenters believed that the chart form with its statutory cross references made it easier for the CFR user to locate statutory authority for various types of loans and investments. At least one commenter

suggested that the chart would be more useful if it were more inclusive and listed additional statutory and regulatory lending and investment powers. Accordingly, OTS is adopting the lending and investment powers chart in the final rule in a more inclusive form with additional references to thrifts' statutory powers with regard to bankers' bank stock, business development credit corporations, unsecured construction loans, deposits, securities issued by the Federal government and government-sponsored enterprises, HUD-insured or guaranteed investments, insured loans, liquidity investments, mortgage-backed securities, nonconforming loans, the National Housing Partnership Corporation and related partnerships and joint ventures, and small business-related securities.<sup>57</sup> Other references in the chart on community development and letters of credit have been modified or removed so that the chart more clearly reflects lending and investment powers specifically authorized by the statute.

### *Section 560.31 Election Regarding Categorization of Loans or Investments and Related Calculations*

This section is derived from current § 545.31, incorporating the modifications described earlier under that section.

### *Section 560.33 Late Charges*

This section is derived from current § 545.34(b). It has been modified as discussed under that section.

### *Section 560.34 Prepayments*

This section is derived from current § 545.34(c). The first sentence of that section has been rewritten to make it easier to understand, but no substantive change is intended. Advanced payments of regular installments are not considered prepayments for purposes of this regulation, as compared to payments to reduce the principal balance due on a loan.

### *Section 560.35 Adjustments to Home Loans*

This section is derived from current § 545.33(c) and has been modified as discussed under that section.

### *Section 560.40 Commercial Paper and Corporate Debt Securities*

This section is derived from paragraphs (b) and (c) of current § 545.75. It has been modified as discussed under that section.

### *Section 560.41 Leasing*

This section consolidates and reorganizes current § 545.53 (finance leasing) and § 545.78 (general leasing authority), incorporating the modifications described under those sections. It has been reorganized to clarify the separate sources of authority and requirements that apply to these two types of leasing.

### *Section 560.42 State and Local Government Obligations*

This section is derived from § 5(c)(1)(H) of the HOLA and paragraphs (a) and (b) of current § 545.72. It is being adopted as proposed.

### *Section 560.43 Foreign Assistance Investments*

This section is a consolidation and reorganization of current §§ 545.39 and 545.73.

#### *Subpart B—Lending and Investment Provisions Applicable to All Savings Associations*

This subpart contains safety and soundness based lending standards and provisions applicable to all savings associations, to the extent that they have the authority to make the investments it discusses.

### *Section 560.93 Lending Limitations*

This section, including its appendices, has been moved, with only technical conforming changes, from § 563.93.

### *Section 560.100 Real Estate Lending Standards; Purpose and Scope*

This section has been transferred without change from § 563.100.

### *Section 560.101 Real Estate Lending Standards*

This section and the accompanying appendix have been transferred with only technical and conforming changes, from § 563.101 and Part 563, Subpart D, Appendix A.

### *Section 560.110 Most Favored Lender Usury Preemption*

This section implements section 4(g) of the HOLA. Section 4(g) provides that, notwithstanding any contrary state law, savings associations may charge interest on any extension of credit at a rate equal to the greater of: (a) One percentage

<sup>57</sup> As part of its subsidiaries and equity investment proposal, OTS has requested comment on other additions to this chart, affecting service corporations, certain open-end management investment companies, and small business investment companies. 61 FR at 29981.

point above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve district in which the savings association is located; or (b) the rate allowed by the laws of the state in which the savings association is located for the state's most favored lender, *i.e.*, the class of state lending institution authorized to charge the highest interest rate. Section 560.110 replaces § 571.22, which is being removed today.

In its January proposal, OTS restated the text of § 571.22, with several changes intended to eliminate unnecessary verbiage. However, OTS also solicited comment regarding whether paragraph (b) of the regulation should be modified to conform more closely to the OCC's most favored lender regulation.

Paragraph (b) of § 571.22 indicated that any savings association electing to make loans at the interest rate authorized for a state most favored lender must also comply with the same "substantive state law requirements" that are applicable to that state lender when making loans of the same type. The OCC interpretive regulation, which implements a parallel statutory provision for national banks, uses a slightly different phrase to describe what types of state laws must be complied with pursuant to the most favored lender doctrine. The OCC requires national banks to comply with all state laws that apply to the state most favored lender and are "material to the determination of the interest rate" authorized under state law.<sup>58</sup> OTS has previously opined that this standard is similar, though not identical, to OTS's "substantive law" standard.<sup>59</sup> OTS specifically requested comment regarding whether paragraph (b) of § 571.22 should be replaced in its entirety with a reference to state laws that are "material to the determination of the interest rate."

Two commenters responding to this inquiry supported adoption of the OCC's regulatory language. The commenters believed that the OCC language is more precise and its adoption would promote parity and uniformity in the agencies' interpretations of most favored lender questions consistent with section 303 of the CDRIA.

A third commenter raised a concern that the OCC's provision ("material to the determination of the interest rate") was narrower in scope than OTS's substantive law standard. This

commenter noted that OTS currently interprets substantive state law requirements to include disclosure laws. The commenter reasoned that by complying with federal disclosure laws and disclosure laws in the state where it is located, a thrift need not comply with disclosure laws in states where it is not located but where borrowers reside. The commenter argued that this approach helps thrifts to make interstate loans more efficiently under a single set of disclosures that comply with federal law and the law of state where it is located without having to comply with a multiplicity of state specific disclosure requirements.

Contrary to the commenter's concern, adopting the "materiality" standard will not subject federal thrifts to the disclosure laws of "non-location" states. New § 560.2(b)(9), discussed above, specifically indicates that state disclosure requirements do not apply to federal thrifts, except when required by § 560.110. Nothing in § 560.110 applies the disclosure laws of non-location states to federal savings associations. Under § 560.110, only the disclosure laws of the location state will ever apply. If the "substantive law" standard were carried forward, the disclosure laws of the location state would apply every time a thrift made a loan under the most favored lender doctrine. By contrast, if the "materiality" standard is adopted, the disclosure laws of the location state will apply only in those rare instances where those laws are material to the determination of the interest rate. Thus, in the interest of reducing regulatory burden and establishing greater uniformity, OTS has decided to adopt the "materiality" standard.

The debate about the "materiality" standard, however, raises a more general question about whether OTS should conform the entire text of its most favored lender regulation to the OCC regulation. In this regard, we note that the courts have recognized that, when enacting section 4(g) of the HOLA, Congress intended to give savings associations the same most favored lender status conferred upon national banks.<sup>60</sup> Thus, OTS and its predecessor, the FHLBB, have long looked to the OCC regulation and other precedent interpreting the national bank most favored lender provision for guidance in interpreting section 4(g) and OTS's implementing regulation.<sup>61</sup> But for the

distinction discussed above regarding the "materiality" standard, differences between OTS and OCC regulations have been purely a matter of syntax, not substance.

In February of this year, after OTS had issued its proposal, the OCC amended and updated its most favored lender regulation.<sup>62</sup> The primary change was to add an express definition of the term "interest" that was consistent with past precedent. The Supreme Court recently upheld this definition as a reasonable construction of the statutory most favored lender provision for national banks.<sup>63</sup> Under the OCC's amended regulation, the term "interest" is defined to include, without limitation, numerical periodic rates, late fees, not sufficient funds fees, overlimit fees, annual fees, cash advance fees, and membership fees.

Given the similarities between section 4(g) of the HOLA and the national bank most favored lender provision, OTS believes that the term "interest" as it appears in section 4(g) and OTS's implementing regulation should be interpreted in a manner consistent with the OCC regulation and the Supreme Court's decision, even if the new OTS regulation did not expressly define the term.<sup>64</sup>

Therefore, rather than perpetuate nonsubstantive differences in syntax that could create confusion, OTS has decided to conform new § 560.110 to the OCC regulation. We do not believe this results in any substantive change from former § 571.22, except for adoption of the "materiality" standard, discussed above. Conforming to the OCC regulation is consistent with the commenters' view that the OCC's syntax is clearer and more precise, and with the congressional command to move toward greater banking agency uniformity.

#### *Section 560.120 Letters of Credit and Other Independent Undertakings To Pay Against Documents*

This section is derived from current § 545.48 and establishes standards for letters of credit for all savings associations, incorporating the modifications discussed under that section.

<sup>58</sup> 12 CFR 7.7310 (revised and recodified at 12 CFR 7.4001, 61 FR at 4869).

<sup>58</sup> 12 CFR 7.7310 (revised and recodified at 12 CFR 7.4001, 61 FR at 4869).

<sup>59</sup> OTS Op. Chief Counsel, Oct. 14, 1992.

<sup>60</sup> *Gavey Properties/762 v. First Financial Savings & Loan*, 845 F.2d 519, 521 (5th Cir. 1988); and 12 CFR 571.22 (1996).

<sup>61</sup> See, *e.g.*, OTS Op. Chief Counsel, Dec. 24, 1992, pp. 3-4.

<sup>62</sup> 61 FR at 4869.

<sup>63</sup> *Smiley v. Citibank (South Dakota), N.A.*, 116 S. Ct. 1730 (1996).

<sup>64</sup> This means, among other things, that when federal thrifts elect to make loans in reliance on the most favored lender rate of their location state, they must comply with any limits the location state imposes on the lending fees encompassed within the term "interest," notwithstanding § 560.2(b)(5). In all other circumstances, state restrictions on loan-related fees are preempted, as provided in § 560.2(b)(5).

**Section 560.121 Investments in State Housing Corporations**

This section is derived from current § 563.95, incorporating the modifications described earlier under that section.

**Section 560.160 Asset Classification**

This section requires each savings association to have an internal system to classify its assets and to establish appropriate valuations or charge-offs, as appropriate. It replaces the more detailed regulation found at current § 563.160.

**Section 560.170 Records for Lending Transactions**

This section contains general loan documentation requirements based on the interagency safety and soundness standards and guidelines found at 12 CFR Part 570. It replaces the specific loan documentation requirements previously found at § 563.170(c) (1)–(10), and incorporates the modifications described earlier under that section.

**Section 560.172 Reevaluation of Real Estate Owned**

This section has been transferred, without change, from § 563.172.

**Subpart C—Alternative Mortgage Transactions**

This subpart contains rules applicable to alternative mortgages originated by federal and state savings associations and certain other state lenders.

**Section 560.210 Disclosures for Adjustable-Rate Mortgage Loans, Adjustment Notices, and Interest-Rate Caps**

This section has been transferred from § 563.99. It has been amended as discussed under that section and to remove a definition, “fixed rate mortgage loan,” that is no longer used in the regulation.

**Section 560.220 Alternative Mortgage Parity Act**

This section (originally proposed as § 560.210) is derived from current § 545.33(f), “Notice of housing creditors regarding alternative mortgage transactions” and applies to state savings associations and certain other state-chartered lenders. OTS has observed that state housing creditors interested in engaging in alternative mortgage transactions could not easily locate § 545.33(f). Placing these

provisions into a subpart specifically dealing with alternative mortgages will make them more accessible. The section has been streamlined and modified to remove cross-references to repealed provisions and to clarify the scope of federal lending regulations applicable to state housing creditors electing to originate loans under the Parity Act. While the proposal indicated that all of new Part 560 would be considered appropriate and applicable to the exercise of the authority under the Parity Act, the final rule has been revised to identify the appropriate sections with greater specificity. One commenter suggested adding language to clarify that this section does not limit the preemption of the imposition of state licensing requirements on federal associations. Because of modifications made to the final preemption regulation at § 560.2, OTS believes that the addition of this language is not necessary. States may not impose lending license requirements on federal thrifts.

**III. Disposition of Existing Lending and Investment Regulations**

Original provision	New provision	Comment
§ 545.31 (a),(b) .....	§§ 560.31(a), 560.3.	Modified. Substance has been moved into § 560.31(a); definitions have been moved into § 560.3.
§ 545.31 (c),(d) .....	§ 560.31 (b),(c) ...	Modified.
§ 545.32(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.32(b) (1),(2) .....	.....	Removed.
§ 545.32(b) (3)-(6) .....	.....	Removed, included as areas in which state law is preempted under § 560.2.
§ 545.32(c) .....	§ 560.3 .....	Substantially unchanged.
§ 545.32(d) .....	.....	Removed.
§ 545.33 Introductory paragraph.	§ 560.3 .....	Substantially unchanged.
§ 545.33(a) .....	.....	Removed, included as area in which state law is preempted under § 560.2.
§ 545.33(b) .....	.....	Removed.
§ 545.33(c) (1)–(3) .....	§ 560.35 .....	Modified.
§ 545.33(c) (4),(5) .....	.....	Removed.
§ 545.33 (d),(e) .....	.....	Removed.
§ 545.33(f) .....	§ 560.220 .....	Modified.
§ 545.34(a) .....	§ 560.2 .....	Modified and reorganized.
§ 545.34(b) .....	§ 560.33 .....	Modified.
§ 545.34(c) .....	§ 560.34 .....	Modified.
§ 545.35 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.36 .....	.....	Removed. Paragraphs (c) and (d) to be incorporated into guidance.
§ 545.37 .....	.....	Removed.
§ 545.38 (a),(b) .....	.....	Removed.
§ 545.38(c) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.39(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.39(b) .....	§ 560.43 .....	Modified.
§ 545.40 .....	.....	Removed.
§ 545.41 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.42 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.43 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.44 .....	.....	Removed.
§ 545.45(a) .....	.....	Removed.
§ 545.45(b) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.45 (c),(d) .....	.....	To be incorporated into guidance.
§ 545.45(e) .....	.....	Removed.
§ 545.46(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.46(b) introductory paragraph and (b)(1).	§ 560.30 .....	Incorporated into lending and investment powers chart.

Original provision	New provision	Comment
§ 545.46(b)(2) .....	.....	Removed.
§ 545.47 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.48(a) .....	§ 560.120 .....	Significantly changed.
§ 545.48(b) .....	.....	Removed.
§ 545.49 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.50(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.50(b) .....	§ 560.3 .....	Substantially unchanged.
§ 545.50(c) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.51(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.51(b) .....	.....	Removed.
§ 545.52 .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.53(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.53 (b)-(d) .....	§ 560.41 .....	Significantly changed.
§ 545.72 Introductory paragraph.	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.72 (a),(b) .....	§ 560.42 .....	Significantly changed.
§ 545.72(c) .....	.....	Removed.
§ 545.73 Introductory paragraph.	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.73 (a),(b) .....	§ 560.43 .....	Modified.
§ 545.74 (c)(1)(vi) .....	.....	Modified.
§ 545.75(a) .....	§ 560.30 .....	Incorporated into lending and investment powers chart.
§ 545.75 (b),(c) .....	§ 560.40 .....	Modified.
§ 545.75(d) .....	.....	Removed.
§ 545.78 .....	§ 560.30. See also § 560.41..	Significantly changed and incorporated into lending and investment powers chart.
§ 556.2 .....	.....	Removed.
§ 556.3 .....	.....	To be incorporated into guidance.
§ 556.10 .....	.....	To be incorporated into guidance.
§ 563.93 .....	§ 560.93 .....	Redesignated with no changes.
§ 563.95 .....	§ 560.121 .....	Significantly changed.
§ 563.97 .....	.....	Removed.
§ 563.99 .....	§ 560.210 .....	Redesignated and modified by removing paragraph (a)(2) and adding new paragraph (g).
§ 563.100 .....	§ 560.100 .....	Redesignated without change.
§ 563.101 .....	§ 560.101 .....	Redesignated without change.
§ 563.160 .....	§ 560.160 .....	Significantly changed.
§ 563.170 (a),(b) .....	.....	Unchanged.
§ 563.170(c) introductory text	.....	Modified.
§ 563.170 (c)(1)-(10) .....	§ 560.170 .....	Significantly changed.
§ 563.170 (d),(e) .....	.....	Unchanged.
§ 563.172 .....	§ 560.172 .....	Unchanged.
§ 571.8 .....	.....	Removed.
§ 571.13 .....	.....	To be incorporated into guidance.
§ 571.20 .....	.....	To be incorporated into guidance.
§ 571.22 .....	§ 560.110 .....	Significantly changed.

#### IV. Administrative Procedure Act

This final rule results from the notice of proposed rulemaking OTS published on January 17, 1996. In addition to the regulatory language proposed in that notice, OTS is today redesignating, without substantive change, other lending-related regulations previously located in Part 563 into new Part 560. Pursuant to section 553(b) of the Administrative Procedure Act, OTS hereby finds that good cause exists not to publish those provisions for public notice and comment. They are merely being renumbered and grouped with other lending-related regulations for the convenience of users, thus public notice and opportunity to comment are unnecessary.

#### V. Paperwork Reduction Act of 1995

Respondents/recordkeepers are not required to respond to this collection of

information unless it displays a currently valid OMB control number.

The recordkeeping requirements contained in 12 CFR 560.170 and 563.170 of this final rule have been submitted to and approved by the Office of Management and Budget under OMB Control No. 1550-0078 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

In response to comments received, OTS has decided to adopt 12 CFR 560.35, which was not part of the proposal. The reporting requirements contained in this section have been submitted to the Office of Management and Budget for review.

Comments on all aspects of these information collections should be sent to the Office of Management and Budget, Paperwork Reduction Project (1550), Washington, DC 20503 with

copies to OTS, 1700 G Street, NW., Washington, DC 20552.

The recordkeeping requirements in this final rule are found in 12 CFR 560.35, 560.170, and 563.170. The reporting and recordkeeping requirements set forth in this final rule are needed by OTS in order to supervise savings associations and develop regulatory policy. The likely recordkeepers are OTS-regulated savings associations. Start-up costs to respondents: None.

Records are to be maintained for the period of time respondent/recordkeeper owns the loan plus three years.

The burden estimates for new § 560.35 are as follows:

*Estimated number of respondents:* 120.

*Estimated average annual burden hours per respondent:* 1.

*Estimated number of hours per response:* 20 hours.

*Estimated number of total annual burden hours:* 2,400 hours.  
*Start-up costs to respondents:* None.

VI. Executive Order 12866

The Director of OTS has determined that this final rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866.

VII. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, OTS certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule does not impose any additional burdens or requirements upon small entities and reduces burdens on all savings associations. The regulations have been reorganized to group all lending regulations together in a single part, which will make the regulations easier to locate and use. A chart setting forth the lending and investment powers of savings associations, with accompanying statutory citations, will make it easier for small savings associations to determine the scope of their lending authority. Loan documentation requirements have been streamlined and should result in less paperwork for small associations holding low-dollar amount, non-complex, loans in their portfolios.

VIII. Unfunded Mandates Act of 1995

OTS has determined that the requirements of this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of more than \$100 million in any one year. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

IX. Effective Date

Section 302 of CDRIA delays the effective date of regulations promulgated by the Federal banking agencies that impose additional reporting, disclosure, or new requirements to the first day of the first calendar quarter following publication of the final rule. OTS believes that CDRIA does not apply to this final rule because it imposes no new burden. It reduces regulatory burden in the lending and investment areas and provides added flexibility.

List of Subjects

12 CFR Part 545

Accounting, Consumer protection, Credit, Electronic funds transfers, Investments, Reporting and

recordkeeping requirements, Savings associations.

12 CFR Part 560

Savings associations.

12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

12 CFR Part 566

Liquidity, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 571

Accounting, Conflicts of interest, Investments, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 590

Banks, banking, Loan programs—housing and community development, Manufactured homes, Mortgages, Savings associations.

Accordingly, and under the authority of 12 U.S.C. 1462a, the Office of Thrift Supervision amends chapter V, title 12, Code of Federal Regulations, as set forth below.

**PART 545—OPERATIONS**

1. The authority citation for part 545 continues to read as follows:

Authority: 12 U.S.C. 1462a, 1463, 1464, 1828.

**§§ 545.31–545.43, 545.45–545.53 [Removed]**

2. Sections 545.31 through 545.43 and 545.45 through 545.53 are removed.

**§§ 545.72–545.73 [Removed]**

3. Sections 545.72 and 545.73 are removed.

**§ 545.74 [Amended]**

4. Section 545.74 is amended by revising paragraph (c)(1)(vi) to read as follows:

**§ 545.74 Service corporations.**

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(vi) Commercial loans and participations therein.

\* \* \* \* \*

**§ 545.75 [Removed]**

5. Section 545.75 is removed.

**§ 545.78 [Removed]**

6. Section 545.78 is removed.

**PART 556—STATEMENTS OF POLICY**

7. The authority citation for part 556 continues to read as follows:

Authority: 5 U.S.C. 552, 559; 12 U.S.C. 1464, 1701j–3; 15 U.S.C. 1693–1693r.

**§§ 556.2, 556.3, 556.10 [Removed]**

8. Sections 556.2, 556.3, and 556.10 are removed.

9. Part 560 is added to read as follows:

**PART 560—LENDING AND INVESTMENT**

Sec.

560.1 General.

560.2 Applicability of law.

560.3 Definitions.

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Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1701j–3, 1828, 3803, 3806; 42 U.S.C. 4106.

**§ 560.1 General.**

(a) *Authority and scope.* This part is being issued by OTS under its general rulemaking and supervisory authority

under the Home Owners' Loan Act (HOLA), 12 U.S.C. 1462 *et seq.* Subpart A of this part sets forth the lending and investment powers of Federal savings associations. Subpart B of this part contains safety-and-soundness based lending and investment provisions applicable to all savings associations. Subpart C of this part addresses alternative mortgages and applies to all savings associations.

(b) *General lending standards.* Each savings association is expected to conduct its lending and investment activities prudently. Each association should use lending and investment standards that are consistent with safety and soundness, ensure adequate portfolio diversification and are appropriate for the size and condition of the institution, the nature and scope of its operations, and conditions in its lending market. Each association should adequately monitor the condition of its portfolio and the adequacy of any collateral securing its loans.

#### § 560.2 Applicability of law.

(a) *Occupation of field.* Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or § 560.110 of this part. For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

(b) *Illustrative examples.* Except as provided in § 560.110 of this part, the

types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:

- (1) Licensing, registration, filings, or reports by creditors;
  - (2) The ability of a creditor to require or obtain private mortgage insurance, insurance for other collateral, or other credit enhancements;
  - (3) Loan-to-value ratios;
  - (4) The terms of credit, including amortization of loans and the deferral and capitalization of interest and adjustments to the interest rate, balance, payments due, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;
  - (5) Loan-related fees, including without limitation, initial charges, late charges, prepayment penalties, servicing fees, and overlimit fees;
  - (6) Escrow accounts, impound accounts, and similar accounts;
  - (7) Security property, including leaseholds;
  - (8) Access to and use of credit reports;
  - (9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents and laws requiring creditors to supply copies of credit reports to borrowers or applicants;
  - (10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;
  - (11) Disbursements and repayments;
  - (12) Usury and interest rate ceilings to the extent provided in 12 U.S.C. 1735f-7a and part 590 of this chapter and 12 U.S.C. 1463(g) and § 560.110 of this part; and
  - (13) Due-on-sale clauses to the extent provided in 12 U.S.C. 1701j-3 and part 591 of this chapter.
- (c) *State laws that are not preempted.* State laws of the following types are not preempted to the extent that they only incidentally affect the lending operations of Federal savings associations or are otherwise consistent with the purposes of paragraph (a) of this section:
- (1) Contract and commercial law;
  - (2) Real property law;
  - (3) Homestead laws specified in 12 U.S.C. 1462a(f);
  - (4) Tort law;
  - (5) Criminal law; and
  - (6) Any other law that OTS, upon review, finds:
    - (i) Furthers a vital state interest; and

(ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.

#### § 560.3 Definitions.

For purposes of this part:

*Consumer loans* include loans for personal, family, or household purposes and loans reasonably incident thereto, and may be made as either open-end or closed-end consumer credit, but do not include credit extended in connection with credit cards nor *bona fide* overdraft loans.

*Home loans* include any loans made on the security of homes (including a unit of a condominium or cooperative), combinations of homes and business property, farm residences, and combinations of farm residences and commercial farm real estate.

*Loan commitment* includes a loan in process, a letter of credit, or any other commitment to extend credit.

*Real estate loan* includes any loan for which a Federal savings association relies substantially upon the real estate as the primary security for the loan. A loan is made on the security of real estate if:

- (1) The security property is real estate pursuant to the law of the state in which the property is located;
- (2) The security interest of the Federal savings association may be enforced as a real estate mortgage or its equivalent pursuant to the law of the state in which the property is located;
- (3) The security property is capable of separate appraisal; and
- (4) With regard to a security property that is a leasehold or other interest for a period of years, the term of the interest extends, or is subject to extension or renewal at the option of the Federal savings association for a term of at least five years following the maturity of the loan.

#### Subpart A—Lending and Investment Powers for Federal Savings Associations

##### § 560.30 General lending and investment powers.

Pursuant to section 5(c) of the HOLA, 12 U.S.C. 1464(c), a Federal savings association may make, invest in, purchase, sell, participate in, or otherwise deal in (including brokerage or warehousing) all loans and investments allowed under section 5(c) of the HOLA including the following loans, extensions of credit, and investments, subject to the limitations indicated and any such clarifying terms, conditions, or case-by-case limitations

as may be prescribed from time to time by the Office by opinion, policy directive, order, or regulation:

LENDING AND INVESTMENT POWERS CHART

Category	HOLA authorization	Statutory Investment Limitations (notes contain applicable regulatory limitations)
Bankers' bank stock .....	5(c)(4)(E)	Same terms as applicable to national banks.
Business development credit corporations .....	5(c)(4)(A)	The lesser of .5% of total outstanding loans or \$250,000.
Commercial loans .....	5(c)(2)(A)	10% of total assets.
Commercial paper and corporate debt securities .....	5(c)(2)(D)	Up to 30% of total assets. <sup>1,2</sup>
Community development loans and equity investments .....	5(c)(3)(B)	5% of total assets, provided equity investments do not exceed 2% of total assets. <sup>3</sup>
Construction loans without security .....	5(c)(3)(D)	In the aggregate, the greater of total capital or 5% of total assets.
Consumer loans .....	5(c)(2)(D)	Up to 35% of total assets. <sup>1,4</sup>
Credit cards .....	5(b)(4)	None. <sup>5</sup>
Deposits in insured depository institutions .....	5(c)(1)(G)	None. <sup>5</sup>
Education loans .....	5(c)(3)(A)	5% of total assets.
Federal government and government-sponsored enterprise securities and instruments.	5(c)(1)(C) 5(c)(1)(D) 5(c)(1)(E) 5(c)(1)(F)	None. <sup>5</sup>
Finance leasing .....	5(c)(1)(B) 5(c)(2)(A) 5(c)(2)(B) 5(c)(2)(D)	Based on purpose and property financed. <sup>6</sup>
Foreign assistance investments .....	5(c)(4)(C)	1% of total assets. <sup>7</sup>
General leasing .....	5(c)(2)(C)	10% of assets. <sup>6</sup>
Home improvement loans .....	5(c)(1)(J)	None. <sup>5</sup>
Home (residential) loans <sup>8</sup> .....	5(c)(1)(B)	None. <sup>5,9</sup>
HUD-insured or guaranteed investments .....	5(c)(1)(O)	None. <sup>5</sup>
Insured loans .....	5(c)(1)(I) 5(c)(1)(K)	None. <sup>5</sup>
Liquidity investments .....	5(c)(1)(M)	None. <sup>5</sup>
Loans secured by deposit accounts .....	5(c)(1)(A)	None. <sup>5,10</sup>
Loans to financial institutions, brokers, and dealers .....	5(c)(1)(L)	None. <sup>5,11</sup>
Manufactured home loans .....	5(c)(1)(J)	None. <sup>5,12</sup>
Mortgage-backed securities .....	5(c)(1)(R)	None. <sup>5</sup>
National Housing Partnership Corporation and related partnerships and joint ventures.	5(c)(1)(N)	None. <sup>5</sup>
Nonconforming loans .....	5(c)(3)(C)	5% of total assets.
Nonresidential real property loans .....	5(c)(2)(B)	400% of total capital. <sup>13</sup>
Small-business-related securities .....	5(c)(1)(S)	None. <sup>5</sup>
State and local government obligations .....	5(c)(1)(H)	None. <sup>5,14</sup>
State housing corporations .....	5(c)(1)(P)	None. <sup>5,15</sup>
Transaction account loans, including overdrafts .....	5(c)(1)(A)	None. <sup>5,16</sup>

NOTES:

<sup>1</sup> For purposes of determining a Federal savings association's percentage of assets limitation, investment in commercial paper and corporate debt securities must be aggregated with the Federal savings association's investment in consumer loans.

<sup>2</sup> A Federal savings association may invest in commercial paper and corporate debt securities, which includes corporate debt securities convertible into stock, subject to the provisions of § 560.40 of this part.

<sup>3</sup> The 2% of assets limitation is a sublimit for investments within the overall 5% of assets limitation on community development loans and investments. The qualitative standards for such loans and investments are set forth in HOLA section 5(c)(3)(B), as explained in an opinion of the OTS Chief Counsel dated May 10, 1995 (available upon request at the address set forth in § 516.1(a) of this chapter).

<sup>4</sup> Amounts in excess of 30% of assets, in aggregate, may be invested only in loans made by the association directly to the original obligor and for which no finder's or referral fees have been paid. A Federal savings association may include loans to dealers in consumer goods to finance inventory and floor planning in the total investment made under this section.

<sup>5</sup> While there is no statutory limit on certain categories of loans and investments, including credit card loans, home improvement loans, and deposit account loans, OTS may establish an individual limit on such loans or investments if the association's concentration in such loans or investments presents a safety and soundness concern.

<sup>6</sup> A Federal savings association may engage in leasing activities subject to the provisions of § 560.41 of this part.

<sup>7</sup> This 1% of assets limitation applies to the aggregate outstanding investments made under the Foreign Assistance Act and in the capital of the Inter-American Savings and Loan Bank. Such investments may be made subject to the provisions of § 560.43 of this part.

<sup>8</sup> A home (or residential) loan includes loans secured by one-to-four family dwellings, multi-family residential property and loans secured by a unit or units of a condominium or housing cooperative.

<sup>9</sup> A Federal savings association may make home loans subject to the provisions of §§ 560.33, 560.34 and 560.35 of this part.

<sup>10</sup> Loans secured by savings accounts and other time deposits may be made without limitation, provided the Federal savings association obtains a lien on, or a pledge of, such accounts. Such loans may not exceed the withdrawable amount of the account.

<sup>11</sup> A Federal savings association may only invest in these loans if they are secured by obligations of, or by obligations fully guaranteed as to principal and interest by, the United States or any of its agencies or instrumentalities, the borrower is a financial institution insured by the Federal Deposit Insurance Corporation or is a broker or dealer registered with the Securities and Exchange Commission, and the market value of the securities for each loan at least equals the amount of the loan at the time it is made.

<sup>12</sup> If the wheels and axles of the manufactured home have been removed and it is permanently affixed to a foundation, a loan secured by a combination of a manufactured home and developed residential lot on which it sits may be treated as a home loan.

<sup>13</sup>Without regard to any limitations of this part, a Federal savings association may make or invest in the fully insured or guaranteed portion of nonresidential real estate loans insured or guaranteed by the Economic Development Administration, the Farmers Home Administration, or the Small Business Administration. Unguaranteed portions of guaranteed loans must be aggregated with uninsured loans when determining an association's compliance with the 400% of capital limitation for other real estate loans.

<sup>14</sup>This category includes obligations issued by any state, territory, or possession of the United States or political subdivision thereof (including any agency, corporation, or instrumentality of a state or political subdivision), subject to § 560.42 of this part.

<sup>15</sup>A Federal savings association may invest in state housing corporations subject to the provisions of § 560.121 of this part.

<sup>16</sup>Payments on accounts in excess of the account balance (overdrafts) on commercial deposit or transaction accounts shall be considered commercial loans for purposes of determining the association's percentage of assets limitation.

**§ 560.31 Election regarding categorization of loans or investments and related calculations.**

(a) If a loan or other investment is authorized under more than one section of the HOLA, as amended, or this part, a Federal savings association may designate under which section the loan or investment has been made. Such a loan or investment may be apportioned among appropriate categories, and may be moved, in whole or part, from one category to another. A loan commitment shall be counted as an investment and included in total assets of a Federal savings association for purposes of calculating compliance with HOLA section 5(c)'s investment limitations only to the extent that funds have been advanced and not repaid pursuant to the commitment.

(b) Loans or portions of loans sold to a third party shall be included in the calculation of a percentage-of-assets or percentage-of-capital investment limitation only to the extent they are sold with recourse.

(c) A Federal savings association may make a loan secured by an assignment of loans to the extent that it could, under applicable law and regulations, make or purchase the underlying assigned loans.

**§ 560.33 Late charges.**

A Federal savings association may include in a home loan contract a provision authorizing the imposition of a late charge with respect to the payment of any delinquent periodic payment. With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, no late charge, regardless of form, shall be assessed or collected by a Federal savings association, unless any billing, coupon, or notice the Federal savings association may provide regarding installment payments due on the loan discloses the date after which the charge may be assessed. A Federal savings association may not impose a late charge more than one time for late payment of the same installment, and any installment payment made by the borrower shall be applied to the longest outstanding installment due. A Federal savings association shall not assess a late charge as to any payment received by it within fifteen days after the due

date of such payment. No form of such late charge permitted by this paragraph shall be considered as interest to the Federal savings association and the Federal savings association shall not deduct late charges from the regular periodic installment payments on the loan, but must collect them as such from the borrower.

**§ 560.34 Prepayments.**

Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless the loan contract or the borrower specifies otherwise. Subject to the terms of the loan contract, a Federal savings association may impose a fee for any prepayment of a loan.

**§ 560.35 Adjustments to home loans.**

(a) For any home loan secured by borrower-occupied property, or property to be occupied by the borrower, adjustments to the interest rate, payment, balance, or term to maturity must comply with the limitations of this section and the disclosure and notice requirements of § 560.210 of this part.

(b) Adjustments to the interest rate shall correspond directly to the movement of an index satisfying the requirements of paragraph (d) of this section. A Federal savings association also may increase the interest rate pursuant to a formula or schedule that specifies the amount of the increase, the time at which it may be made, and which is set forth in the loan contract. A Federal savings association may decrease the interest rate at any time.

(c) Adjustments to the payment and the loan balance that do not reflect an interest-rate adjustment may be made if:

(1) The adjustments reflect a change in an index that may be used pursuant to paragraph (d) of this section;

(2) In the case of a payment adjustment, the adjustment reflects a change in the loan balance or is made pursuant to a formula, or to a schedule specifying the percentage or dollar change in the payment as set forth in the loan contract; or

(3) In the case of an open-end line-of-credit loan, the adjustment reflects an advance taken by the borrower under the line-of-credit and is permitted by the loan contract.

(d)(1) Any index used must be readily available and independently verifiable. If set forth in the loan contract, an association may use any combination of indices, a moving average of index values, or more than one index during the term of a loan.

(2) Except as provided in paragraph (d)(3) of this section, any index used must be a national or regional index.

(3) A Federal savings association may use an index not satisfying the requirements of paragraph (d)(2) of this section 30 days after filing a notice in accordance with § 516.1(c) of this chapter unless, within that 30-day period, OTS has notified the association that the notice presents supervisory concerns or raises significant issues of law or policy. If OTS does notify the association of such concerns or issues, the Federal savings association may not use such an index unless and until it applies for and receives OTS's prior written approval in accordance with § 516.1(c) of this chapter.

**§ 560.40 Commercial paper and corporate debt securities.**

Pursuant to HOLA section 5(c)(2)(D), a Federal savings association may invest in, sell, or hold commercial paper and corporate debt securities subject to the provisions of this section.

(a) *Limitations.* (1) Commercial paper must be:

(i) As of the date of purchase, rated in either one of the two highest categories by at least two nationally recognized investment ratings services as shown by the most recently published rating made of such investments; or

(ii) If unrated, guaranteed by a company having outstanding paper that is rated as provided in paragraph (a)(1)(i) of this section.

(2) Corporate debt securities must be:

(i) Securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value; and

(ii) Rated in one of the four highest categories by a nationally recognized investment ratings service at its most recently published rating before the date of purchase of the security.

(3) A Federal savings association's total investment in the commercial paper and corporate debt securities of any one issuer, or issued by any one

person or entity affiliated with such issuer, together with other loans, shall not exceed the general lending limitations contained in § 560.93(c) of this part.

(4) Investments in corporate debt securities convertible into stock are subject to the following additional limitations:

- (i) The purchase of securities convertible into stock at the option of the issuer is prohibited;
- (ii) At the time of purchase, the cost of such securities must be written down to an amount that represents the investment value of the securities considered independently of the conversion feature; and
- (iii) Federal savings associations are prohibited from exercising the conversion feature.

(5) A Federal savings association shall maintain information in its files adequate to demonstrate that it has exercised prudent judgment in making investments under this section.

(b) Notwithstanding the limitations contained in this section, the Office may permit investment in corporate debt securities of another savings association in connection with the purchase or sale of a branch office or in connection with a supervisory merger or acquisition.

#### § 560.41 Leasing.

(a) *Permissible activities.* Subject to the limitations of this section, a Federal savings association may engage in leasing activities. These activities include becoming the legal or beneficial owner of tangible personal property or real property for the purpose of leasing such property, obtaining an assignment of a lessor's interest in a lease of such property, and incurring obligations incidental to its position as the legal or beneficial owner and lessor of the leased property.

(b) *Definitions.* For the purposes of this section:

(1) The term *net lease* means a lease under which the Federal savings association will not, directly or indirectly, provide or be obligated to provide for:

- (i) The servicing, repair or maintenance of the leased property during the lease term;
- (ii) The purchasing of parts and accessories for the leased property, except that improvements and additions to the leased property may be leased to the lessee upon its request in accordance with the full-payout requirements of paragraph (c)(2)(i) of this section;
- (iii) The loan of replacement or substitute property while the leased property is being serviced;

(iv) The purchasing of insurance for the lessee, except where the lessee has failed to discharge a contractual obligation to purchase or maintain insurance; or

(v) The renewal of any license, registration, or filing for the property unless such action by the Federal savings association is necessary to protect its interest as an owner or financier of the property.

(2) The term *full-payout lease* means a lease transaction in which any unguaranteed portion of the estimated residual value relied on by the association to yield the return of its full investment in the leased property, plus the estimated cost of financing the property over the term of the lease, does not exceed 25% of the original cost of the property to the lessor. In general, a lease will qualify as a full-payout lease if the scheduled payments provide at least 75% of the principal and interest payments that a lessor would receive if the finance lease were structured as a market-rate loan.

(3) The term *realization of investment* means that a Federal savings association that enters into a lease financing transaction must reasonably expect to realize the return of its full investment in the leased property, plus the estimated cost of financing the property over the term of the lease from:

- (i) Rentals;
- (ii) Estimated tax benefits, if any; and
- (iii) The estimated residual value of the property at the expiration of the term of the lease.

(c) *Finance leasing*—(1) *Investment limits.* A Federal savings association may exercise its authority under HOLA sections 5(c)(1)(B) (residential real estate loans), 5(c)(2)(A) (commercial, business, corporate or agricultural loans), 5(c)(2)(B) (nonresidential real estate loans), and 5(c)(2)(D) (consumer loans) by conducting leasing activities that are the functional equivalent of loans made under those HOLA sections. These activities are commonly referred to as financing leases. Such financing leases are subject to the same investment limits that apply to loans made under those sections. For example, a financing lease of tangible personal property made to a natural person for personal, family or household purposes is subject to all limitations applicable to the amount of a Federal savings association's investment in consumer loans. A financing lease made for commercial, corporate, business, or agricultural purposes is subject to all limitations applicable to the amount of a Federal savings association's investment in commercial loans. A financing lease of residential or nonresidential real

property is subject to all limitations applicable to the amount of a Federal savings association's investment in these types of real estate loans.

(2) *Functional equivalent of lending.* To qualify as the functional equivalent of a loan:

(i) The lease must be a net, full-payout lease representing a non-cancelable obligation of the lessee, notwithstanding the possible early termination of the lease;

(ii) The portion of the estimated residual value of the property relied upon by the lessor to satisfy the requirements of a full-payout lease must be reasonable in light of the nature of the leased property and all relevant circumstances so that realization of the lessor's full investment plus the cost of financing the property depends primarily on the creditworthiness of the lessee, and not on the residual market value of the leased property; and

(iii) At the termination of a financing lease, either by expiration or default, property acquired must be liquidated or released on a net basis as soon as practicable. Any property held in anticipation of re-leasing must be reevaluated and recorded at the lower of fair market value or book value.

(d) *General leasing.* Pursuant to section 5(c)(2)(C) of the HOLA, a Federal savings association may invest in tangible personal property, including vehicles, manufactured homes, machinery, equipment, or furniture, for the purpose of leasing that property. In contrast to financing leases, lease investments made under this authority need not be the functional equivalent of loans.

(e) *Leasing salvage powers.* If, in good faith, a Federal savings association believes that there has been an unanticipated change in conditions that threatens its financial position by significantly increasing its exposure to loss, it may:

(1) As the owner and lessor, take reasonable and appropriate action to salvage or protect the value of the property or its interest arising under the lease;

(2) As the assignee of a lessor's interest in a lease, become the owner and lessor of the leased property pursuant to its contractual right, or take any reasonable and appropriate action to salvage or protect the value of the property or its interest arising under the lease; or

(3) Include any provisions in a lease, or make any additional agreements, to protect its financial position or investment in the circumstances set forth in paragraphs (e)(1) and (e)(2) of this section.

**§ 560.42 State and local government obligations.**

Pursuant to HOLA section 5(c)(1)(H), a Federal savings association may invest in obligations issued by any state, territory, possession, or political subdivision thereof, subject to the following conditions:

(a) A Federal savings association may not invest more than 10% of its total capital in obligations of any one issuer, exclusive of general obligations of the issuer.

(b) Except as provided in paragraph (c) of this section, the obligations must:

(1) Continue to hold one of the four highest national investment grade ratings; or

(2) Must be issued by a public housing agency and backed by the full faith and credit of the United States.

(c) Notwithstanding the limitations in paragraph (b) of this section, a Federal savings association may invest:

(1) In the aggregate, up to one percent of its assets in the obligations of a state, territory, possession, or political subdivision in which the association's home office or a branch office is located; or

(2) In any obligations approved by the Office.

**§ 560.43 Foreign assistance investments.**

Pursuant to HOLA section 5(c)(4)(C), a Federal savings association may make foreign assistance investments in an aggregate amount not to exceed one percent of its assets, subject to the following conditions:

(a) For any investment made under the Foreign Assistance Act, the loan agreement shall specify what constitutes an event of default, and provide that upon default in payment of principal or interest under such agreement, the entire amount of outstanding indebtedness thereunder shall become immediately due and payable, at the lender's option. Additionally, the contract of guarantee shall cover 100% of any loss of investment thereunder, except for any portion of the loan arising out of fraud or misrepresentation for which the party seeking payment is responsible, and provide that the guarantor shall pay for any such loss in U.S. dollars within a specified reasonable time after the date of application for payment.

(b) To make any investments in the share capital and capital reserve of the Inter-American Savings and Loan Bank, a Federal savings association must be adequately capitalized and have adequate allowances for loan and lease losses. The Federal savings association's aggregate investment in such capital or capital reserve, including the amount of

any obligations undertaken to provide said Bank with reserve capital in the future (call-able capital), must not, as a result of such investment, exceed the lesser of one-quarter of 1% of its assets or \$100,000.

**Subpart B—Lending and Investment Provisions Applicable to all Savings Associations****§ 560.93 Lending limitations.**

(a) *Scope.* This section applies to all loans and extensions of credit made by a savings association and its subsidiaries. This section does not apply to loans made by a savings association to its subsidiaries or to its affiliates. The terms *subsidiary* and *affiliate* have the same meanings as those terms are defined in § 563.41 of this chapter.

(b) *Definitions.* In applying these lending limitations, savings associations shall apply the definitions and interpretations promulgated by the Office of the Comptroller of the Currency consistent with 12 U.S.C. 84. See 12 CFR part 32. In applying these definitions, pursuant to 12 U.S.C. 1464, savings associations shall use the terms *savings association*, *savings associations*, and *savings association's* in place of the terms *national bank* and *bank*, *banks*, and *bank's*, respectively. For purposes of this section:

(1) The term *one borrower* has the same meaning as the term *person* set forth at 12 CFR part 32. It also includes, in addition to the definition cited therein, a *financial institution* as defined at § 561.19 of this chapter.

(2) The term *company* means a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term *company* includes a *savings association* and a *bank*.

(3) *Contractual commitment to advance funds* has the meaning set forth in 12 CFR part 32.

(4) *Loans and extensions of credit* has the meaning set forth in 12 CFR part 32, and includes investments in commercial paper and corporate debt securities. The Office expressly reserves its authority to deem other arrangements that are, in substance, *loans and extensions of credit* to be encompassed by this term.

(5) The term *loans* as used in the phrase *Loans to one borrower to finance the sale of real property acquired in satisfaction of debts previously contracted for in good faith* does not include an association's taking of a purchase money mortgage note from the purchaser *provided that*:

(i) No new funds are advanced by the association to the borrower; and

(ii) The association is not placed in a more detrimental position as a result of the sale.

(6) The term *fully phased-in capital standards* means the capital standards that will be in effect at the expiration of all statutory and regulatory phase-in requirements set forth in 12 U.S.C. 1464(t) and §§ 567.2, 567.5, and 567.9 of this chapter.

(7) *Readily marketable collateral* has the meaning set forth in 12 CFR part 32.

(8) *Residential housing units* has the same meaning as the term *residential real estate* set forth in § 541.23 of this chapter. The term *to develop* includes the various phases necessary to produce housing units as an end product, to include: acquisition, development and construction; development and construction; construction; rehabilitation; or conversion. The term *domestic* includes units within the fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, and the Pacific Islands.

(9) *Single family dwelling unit* has the meaning set forth in § 541.20 of this chapter.

(10) A *standby letter of credit* has the meaning set forth in 12 CFR part 32.

(11) *Unimpaired capital and unimpaired surplus* means—

(i) A savings association's core capital and supplementary capital included in its total capital under part 567 of this chapter; plus

(ii) The balance of a savings association's allowance for loan and lease losses not included in supplementary capital under part 567 of this chapter; plus

(iii) The amount of a savings association's loans to, investments in, and advances to subsidiaries not included in calculating core capital under part 567 of this chapter.

(c) *General limitation.* Section 5200 of the Revised Statutes (12 U.S.C. 84) shall apply to savings associations in the same manner and to the same extent as it applies to national banks. This statutory provision and lending limit regulations and interpretations promulgated by the Office of the Comptroller of the Currency pursuant to a rulemaking conducted in accordance with the provisions of the Administrative Procedure Act, 5 U.S.C. 553 et seq. (including the regulations appearing at 12 CFR part 32) shall apply to savings associations in the same manner and to the same extent as these provisions apply to national banks:

(1) The total loans and extensions of credit by a savings association to one borrower outstanding at one time and not fully secured, as determined in the same manner as determined under 12

U.S.C. 84(a)(2), by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 percent of the unimpaired capital and unimpaired surplus of the association.

(2) The total loans and extensions of credit by a savings association to one borrower outstanding at one time and fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the funds outstanding shall not exceed 10 percent of the unimpaired capital and unimpaired surplus of the association. This limitation shall be separate from and in addition to the limitation contained in paragraph (c)(1) of this section.

(d) *Exceptions to the general limitation*—(1) *\$500,000 exception.* If a savings association's aggregate lending limitation calculated under paragraphs (c)(1) and (c)(2) of this section is less than \$500,000, notwithstanding this aggregate limitation in paragraphs (c)(1) and (c)(2) of this section, such savings association may have total loans and extensions of credit, for any purpose, to one borrower outstanding at one time not to exceed \$500,000.

(2) *Statutory exceptions.* The exceptions to the lending limits set forth in 12 U.S.C. 84 and 12 CFR part 32 are applicable to savings associations in the same manner and to the extent as they apply to national banks.

(3) *Loans to develop domestic residential housing units.* Subject to paragraph (d)(4) of this section, a savings association may make loans to one borrower to develop domestic residential housing units, not to exceed the lesser of \$30,000,000 or 30 percent of the savings association's unimpaired capital and unimpaired surplus, including all amounts loaned under the authority of the General Limitation set forth under paragraphs (c)(1) and (c)(2) of this section, *provided that:*

(i) The final purchase price of each single family dwelling unit the development of which is financed under this paragraph (d)(3) does not exceed \$500,000;

(ii) The savings association is, and continues to be, in compliance with its fully phased-in capital standards, as defined in paragraph (b)(6) of this section;

(iii) OTS permits, subject to conditions it may impose, the savings association to use the higher limit set forth under this paragraph (d)(3). A savings association that meets the requirements of paragraphs (d)(3) (i), (ii), (iv) and (v) of this section and that

meets the requirements for "expedited treatment" under § 516.3(a) of this chapter may use the higher limit set forth under this paragraph (d)(3) if the savings association has filed a notice with OTS that it intends to use the higher limit at least 30 days prior to the proposed use. A savings association that meets the requirements of paragraphs (d)(3) (i), (ii), (iv) and (v) of this section and that meets the requirements for "standard treatment" under § 516.3(b) of this chapter may use the higher limit set forth under this paragraph (d)(3) if the savings association has filed a notice with OTS and an order has been issued permitting the savings association to use the higher limit;

(iv) Loans made under this paragraph (d)(3) to all borrowers do not, in aggregate, exceed 150 percent of the savings association's unimpaired capital and unimpaired surplus; and

(v) Such loans comply with the applicable loan-to-value requirements that apply to Federal savings associations.

(4) The authority of a savings association to make a loan or extension of credit under the exception in paragraph (d)(3) of this section ceases immediately upon the association's failure to comply with any one of the requirements set forth in paragraph (d)(3) of this section or any condition(s) set forth in a Director's order under paragraph (d)(3)(iii) of this section.

(5) Notwithstanding the limit set forth in paragraphs (c)(1) and (c)(2) of this section, a savings association may invest up to 10 percent of unimpaired capital and unimpaired surplus in the obligations of one issuer evidenced by:

(i) Commercial paper rated, as of the date of purchase, as shown by the most recently published rating by at least two nationally recognized investment rating services in the highest category; or

(ii) Corporate debt securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value, and that are rated in one of the two highest categories by a nationally recognized investment rating service in its most recently published ratings before the date of purchase of the security.

(e) *Loans to finance the sale of REO.* A savings association's loans to one borrower to finance the sale of real property acquired in satisfaction of debts previously contracted for in good faith shall not, when aggregated with all other loans to such borrower, exceed the General Limitation in paragraph (c)(1) of this section.

(f) *Calculating compliance and recordkeeping.* (1) The amount of an association's unimpaired capital and

unimpaired surplus pursuant to paragraph (b)(11) of this section shall be calculated as of the association's most recent periodic report required to be filed with OTS prior to the date of granting or purchasing the loan or otherwise creating the obligation to repay funds, unless the association knows, or has reason to know, based on transactions or events actually completed, that such level has changed significantly, upward or downward, subsequent to filing of such report.

(2) If a savings association or subsidiary thereof makes a loan or extension of credit to any one borrower, as defined in paragraph (b)(1) of this section, in an amount that, when added to the total balances of all outstanding loans owed to such association and its subsidiary by such borrower, exceeds the greater of \$500,000 or 5 percent of unimpaired capital and unimpaired surplus, the records of such association or its subsidiary with respect to such loan shall include documentation showing that such loan was made within the limitations of paragraphs (c) and (d) of this section; for the purpose of such documentation such association or subsidiary may require, and may accept in good faith, a certification by the borrower identifying the persons, entities, and interests described in the definition of one borrower in paragraph (b)(1) of this section.

(g) [Reserved]

(h) *More stringent restrictions.* The Director may impose more stringent restrictions on a savings association's loans to one borrower if the Director determines that such restrictions are necessary to protect the safety and soundness of the savings association.

#### Appendix to § 560.93—Interpretations

##### *Section 560.93–100 Interrelation of General Limitation With Exception for Loans To Develop Domestic Residential Housing Units*

1. The § 560.93(d)(3) exception for loans to one person to develop domestic residential housing units is characterized in the regulation as an "alternative" limit. This exceptional \$30,000,000 or 30 percent limitation does not operate *in addition to* the 15 percent General Limitation or the 10 percent additional amount an association may loan to one borrower secured by readily marketable collateral, but serves as the uppermost limitation on a savings association's lending to any one person once an association employs this exception. An example will illustrate the Office's interpretation of the application of this rule:

*Example:* Savings Associations A's lending limitation as calculated under the 15 percent General Limitation is \$800,000. If Association A lends Y \$800,000 for commercial purposes, Association A cannot lend Y an *additional* \$1,600,000, or 30 percent of capital and surplus, to develop

residential housing units under the paragraph (d)(3) exception. The (d)(3) exception operates as the uppermost limitation on all lending to one borrower (for associations that may employ this exception) and includes any amounts loaned to the same borrower under the General Limitation. Association A, therefore, may lend only an additional \$800,000 to Y, provided the paragraph (d)(3) prerequisites have been met. The amount loaned under the authority of the General Limitation (\$800,000), when added to the amount loaned under the exception (\$800,000), yields a sum that does not exceed the 30 percent uppermost limitation (\$1,600,000).

2. This result does not change even if the facts are altered to assume that some or all of the \$800,000 amount of lending permissible under the General Limitation's 15 percent basket is not used, or is devoted to the development of domestic residential housing units.

In other words, using the above example, if Association A lends Y \$400,000 for commercial purposes and \$300,000 for residential purposes—both of which would be permitted under the Association's \$800,000 General Limitation—Association A's remaining permissible lending to Y would be: first, an additional \$100,000 under the General Limitation, and then another \$800,000 to develop domestic residential housing units if the Association meets the paragraph (d)(3) prerequisites. (The latter is \$800,000 because in no event may the total lending to Y exceed 30 percent of unimpaired capital and unimpaired surplus). If Association A did not lend Y the remaining \$100,000 permissible under the General Limitation, its permissible loans to develop domestic residential housing units under paragraph (d)(3) would be \$900,000 instead of \$800,000 (the total loans to Y would still equal \$1,600,000).

3. In short, under the paragraph (d)(3) exception, the 30 percent or \$30,000,000 limit will always operate as the uppermost limitation, unless of course the association does not avail itself of the exception and merely relies upon its General Limitation.

*Section 560.93-101 Interrelationship Between the General Limitation and the 150 Percent Aggregate Limit on Loans to all Borrowers To Develop Domestic Residential Housing Units*

1. The Office has already received numerous questions regarding the allocation of loans between the different lending limit "baskets," i.e., the 15 percent General Limitation basket and the 30 percent Residential Development basket. In general, the inquiries concern the manner in which an association may "move" a loan from the General Limitation basket to the Residential Development basket. The following example is intended to provide guidance:

*Example:* Association A's General Limitation under section 5(u)(1) is \$15 million. In January, Association A makes a \$10 million loan to Borrower to develop domestic residential housing units. At the time the loan was made, Association A had not received approval under a Director order to avail itself of the residential development

exception to lending limits. Therefore, the \$10 million loan is made under Association A's General Limitation.

2. In June, Association A receives authorization to lend under the Residential Development exception. In July, Association A lends \$3 million to Borrower to develop domestic residential housing units. In August, Borrower seeks an additional \$12 million commercial loan from Association A. Association A cannot make the loan to Borrower, however, because it already has an outstanding \$10 million loan to Borrower that counts against Association A's General Limitation of \$15 million. Thus, Association A may lend only up to an additional \$5 million to Borrower under the General Limitation.

3. However, Association A may be able to reallocate the \$10 million loan it made to Borrower in January to its Residential Development basket provided that: (1) Association A has obtained authority under a Director's order to avail itself of the additional lending authority for residential development and maintains compliance with all prerequisites to such lending authority; (2) the original \$10 million loan made in January constitutes a loan to develop domestic residential housing units as defined; and (3) the housing unit(s) constructed with the funds from the January loan remain in a stage of "development" at the time Association A reallocates the loan to the domestic residential housing basket. The project must be in a stage of acquisition, development, construction, rehabilitation, or conversion in order for the loan to be reallocated.

4. If Association A is able to reallocate the \$10 million loan made to Borrower in January to its Residential Development basket, it may make the \$12 million commercial loan requested by Borrower in August. Once the January loan is reallocated to the Residential Development basket, however, the \$10 million loan counts towards Association's 150 percent aggregate limitation on loans to all borrowers under the residential development basket (section 5(u)(2)(A)(ii)(IV)).

5. If Association A reallocates the January loan to its domestic residential housing basket and makes an additional \$12 million commercial loan to Borrower, Association A's totals under the respective limitations would be: \$12 million under the General Limitation; and \$13 million under the Residential Development limitation. The full \$13 million residential development loan counts toward Association A's aggregate 150 percent limitation.

**§ 560.100 Real estate lending standards; purpose and scope.**

This section, and § 560.101 of this subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o), prescribe standards for real estate lending to be used by savings associations and all their includable subsidiaries, as defined in 12 CFR 567.1(l), over which the savings associations exercise control, in

adopting internal real estate lending policies.

**§ 560.101 Real estate lending standards.**

(a) Each savings association shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) (1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the savings association's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the savings association's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the savings association's real estate lending policies.

(c) Each savings association must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

**Appendix to § 560.101—Interagency Guidelines for Real Estate Lending Policies**

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.<sup>1</sup> These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and

<sup>1</sup> The agencies have adopted a uniform rule on real estate lending. See 12 CFR Part 365 (FDIC); 12 CFR Part 208, Subpart C (FRB); 12 CFR Part 34, Subpart D (OCC); and 12 CFR 560.100-560.101 (OTS).

scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

**Loan Portfolio Management Considerations**

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

- Identify the geographic areas in which the institution will consider lending.
  - Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).
  - Identify appropriate terms and conditions by type of real estate loan.
  - Establish loan origination and approval procedures, both generally and by size and type of loan.
  - Establish prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.
  - Establish review and approval procedures for exception loans, including loans with loan-to-value percentages in excess of supervisory limits.
  - Establish loan administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review.
  - Establish real estate appraisal and evaluation programs.
  - Require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.
- The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include:
- The size and financial condition of the institution.
  - The expertise and size of the lending staff.
  - The need to avoid undue concentrations of risk.
  - Compliance with all real estate related laws and regulations, including the Community Reinvestment Act, anti-discrimination laws, and for savings associations, the Qualified Thrift Lender test.
  - Market conditions.
- The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:
- Demographic indicators, including population and employment trends.
  - Zoning requirements.

- Current and projected vacancy, construction, and absorption rates.
- Current and projected lease terms, rental rates, and sales prices, including concessions.
- Current and projected operating expenses for different types of projects.
- Economic indicators, including trends and diversification of the lending area.
- Valuation trends, including discount and direct capitalization rates.

**Underwriting Standards**

Prudently underwritten real estate loans should reflect all relevant credit factors, including:

- The capacity of the borrower, or income from the underlying property, to adequately service the debt.
- The value of the mortgaged property.
- The overall creditworthiness of the borrower.
- The level of equity invested in the property.
- Any secondary sources of repayment.
- Any additional collateral or credit enhancements (such as guarantees, mortgage insurance or takeout commitments).

The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address:

- The maximum loan amount by type of property.
  - Maximum loan maturities by type of property.
  - Amortization schedules.
  - Pricing structure for different types of real estate loans.
  - Loan-to-value limits by type of property.
- For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property:
- Requirements for feasibility studies and sensitivity and risk analyses (e.g., sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses).
  - Minimum requirements for initial investment and maintenance of hard equity by the borrower (e.g., cash or unencumbered investment in the underlying property).
  - Minimum standards for net worth, cash flow, and debt service coverage of the borrower or underlying property.
  - Standards for the acceptability of and limits on non-amortizing loans.
  - Standards for the acceptability of and limits on the use of interest reserves.
  - Pre-leasing and pre-sale requirements for income-producing property.
  - Pre-sale and minimum unit release requirements for non-income-producing property loans.
  - Limits on partial recourse or nonrecourse loans and requirements for guarantor support.
  - Requirements for takeout commitments.
  - Minimum covenants for loan agreements.

**Loan Administration**

The institution should also establish loan administration procedures for its real estate portfolio that address:

- Documentation, including:
  - Type and frequency of financial statements, including requirements for verification of information provided by the borrower;
  - Type and frequency of collateral evaluations (appraisals and other estimates of value).
- Loan closing and disbursement.
- Payment processing.
- Escrow administration.
- Collateral administration.
- Loan payoffs.
- Collections and foreclosure, including:
  - Delinquency follow-up procedures;
  - Foreclosure timing;
  - Extensions and other forms of forbearance;
  - Acceptance of deeds in lieu of foreclosure.
- Claims processing (e.g., seeking recovery on a defaulted loan covered by a government guaranty or insurance program).
- Servicing and participation agreements.

**Supervisory Loan-to-Value Limits**

Institutions should establish their own internal loan-to-value limits for real estate loans. These internal limits should not exceed the following supervisory limits:

Loan category	Loan-to-value limit (percent)
Raw land .....	65
Land development .....	75
Construction:	
Commercial, multifamily, <sup>1</sup>	
and other nonresidential ....	80
1- to 4-family residential .....	85
Improved property .....	85
Owner-occupied 1- to 4-family and home equity .....	( <sup>2</sup> )

<sup>1</sup> Multifamily construction includes condominiums and cooperatives.

<sup>2</sup> A loan-to-value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1- to 4-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

The supervisory loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each

property. To ensure that collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.

In establishing internal loan-to-value limits, each lender is expected to carefully consider the institution-specific and market factors listed under "Loan Portfolio Management Considerations," as well as any other relevant factors, such as the particular subcategory or type of loan. For any subcategory of loans that exhibits greater credit risk than the overall category, a lender should consider the establishment of an internal loan-to-value limit for that subcategory that is lower than the limit for the overall category.

The loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan. Other credit factors to be taken into account are highlighted in the "Underwriting Standards" section above. Because of these other factors, the establishment of these supervisory limits should not be interpreted to mean that loans at these levels will automatically be considered sound.

#### Loans in Excess of the Supervisory Loan-to-Value Limits

The agencies recognize that appropriate loan-to-value limits vary not only among categories of real estate loans but also among individual loans. Therefore, it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits, based on the support provided by other credit factors. Such loans should be identified in the institutions' records, and their aggregate amount reported at least quarterly to the institution's board of directors. (See additional reporting requirements described under "Exceptions to the General Policy.") The aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital.<sup>2</sup> Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non-1-to-4 family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

In determining the aggregate amount of such loans, institutions should: (a) Include all loans secured by the same property if any one of those loans exceeds the supervisory loan-to-value limits; and (b) include the recourse obligation of any such loan sold with recourse. Conversely, a loan should no longer be reported to the directors as part of aggregate totals when reduction in principal or senior liens, or additional contribution of collateral or equity (e.g., improvements to the

real property securing the loan), bring the loan-to-value ratio into compliance with supervisory limits.

#### Excluded Transactions

The agencies also recognize that there are a number of lending situations in which other factors significantly outweigh the need to apply the supervisory loan-to-value limits. These include:

- Loans guaranteed or insured by the U.S. government or its agencies, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.
- Loans backed by the full faith and credit of a state government, provided that the amount of the assurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.
- Loans guaranteed or insured by a state, municipal or local government, or an agency thereof, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit, and provided that the lender has determined that the guarantor or insurer has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement.
- Loans that are to be sold promptly after origination, without recourse, to a financially responsible third party.
- Loans that are renewed, refinanced, or restructured without the advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or loans that are renewed, refinanced, or restructured in connection with a workout situation, either with or without the advancement of new funds, where consistent with safe and sound banking practices and part of a clearly defined and well-documented program to achieve orderly liquidation of the debt, reduce risk of loss, or maximize recovery on the loan.
- Loans that facilitate the sale of real estate acquired by the lender in the ordinary course of collecting a debt previously contracted in good faith.
- Loans for which a lien on or interest in real property is taken as additional collateral through an abundance of caution by the lender (e.g., the institution takes a blanket lien on all or substantially all of the assets of the borrower, and the value of the real property is low relative to the aggregate value of all other collateral).
- Loans, such as working capital loans, where the lender does not rely principally on real estate as security and the extension of credit is not used to acquire, develop, or construct permanent improvements on real property.
- Loans for the purpose of financing permanent improvements to real property, but not secured by the property, if such security interest is not required by prudent underwriting practice.

#### Exceptions to the General Lending Policy

Some provision should be made for the consideration of loan requests from creditworthy borrowers whose credit needs do not fit within the institution's general

lending policy. An institution may provide for prudently underwritten exceptions to its lending policies, including loan-to-value limits, on a loan-by-loan basis. However, any exceptions from the supervisory loan-to-value limits should conform to the aggregate limits on such loans discussed above.

The board of directors is responsible for establishing standards for the review and approval of exception loans. Each institution should establish an appropriate internal process for the review and approval of loans that do not conform to its own internal policy standards. The approval of any such loan should be supported by a written justification that clearly sets forth all of the relevant credit factors that support the underwriting decision. The justification and approval documents for such loans should be maintained as a part of the permanent loan file. Each institution should monitor compliance with its real estate lending policy and individually report exception loans of a significant size to its board of directors.

#### Supervisory Review of Real Estate Lending Policies and Practices

The real estate lending policies of institutions will be evaluated by examiners during the course of their examinations to determine if the policies are consistent with safe and sound lending practices, these guidelines, and the requirements of the regulation. In evaluating the adequacy of the institution's real estate lending policies and practices, examiners will take into consideration the following factors:

- The nature and scope of the institution's real estate lending activities.
- The size and financial condition of the institution.
- The quality of the institution's management and internal controls.
- The expertise and size of the lending and loan administration staff.
- Market conditions.

Lending policy exception reports will also be reviewed by examiners during the course of their examinations to determine whether the institutions' exceptions are adequately documented and appropriate in light of all of the relevant credit considerations. An excessive volume of exceptions to an institution's real estate lending policy may signal a weakening of its underwriting practices, or may suggest a need to revise the loan policy.

#### Definitions

For the purposes of these Guidelines:

*Construction loan* means an extension of credit for the purpose of erecting or rehabilitating buildings or other structures, including any infrastructure necessary for development.

*Extension of credit or loan means:*

(1) The total amount of any loan, line of credit, or other legally binding lending commitment with respect to real property; and

(2) The total amount, based on the amount of consideration paid, of any loan, line of credit, or other legally binding lending commitment acquired by a lender by purchase, assignment, or otherwise.

<sup>2</sup>For the state member banks, the term "total capital" means "total risk-based capital" as defined in Appendix A to 12 CFR Part 208. For insured state non-member banks, "total capital" refers to that term described in table I of Appendix A to 12 CFR Part 325. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 567.5(c).

*Improved property loan* means an extension of credit secured by one of the following types of real property:

- (1) Farmland, ranchland or timberland committed to ongoing management and agricultural production;
- (2) 1- to 4-family residential property that is not owner-occupied;
- (3) Residential property containing five or more individual dwelling units;
- (4) Completed commercial property; or
- (5) Other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied 1- to 4-family residential property.

*Land development loan* means an extension of credit for the purpose of improving unimproved real property prior to the erection of structures. The improvement of unimproved real property may include the laying or placement of sewers, water pipes, utility cables, streets, and other infrastructure necessary for future development.

*Loan origination* means the time of inception of the obligation to extend credit (i.e., when the last event or prerequisite, controllable by the lender, occurs causing the lender to become legally bound to fund an extension of credit).

*Loan-to-value* or *loan-to-value ratio* means the percentage or ratio that is derived at the time of loan origination by dividing an extension of credit by the total value of the property(ies) securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral that secures the extension of credit. The total amount of all senior liens on or interests in such property(ies) should be included in determining the loan-to-value ratio. When mortgage insurance or collateral is used in the calculation of the loan-to-value ratio, and such credit enhancement is later released or replaced, the loan-to-value ratio should be recalculated.

*Other acceptable collateral* means any collateral in which the lender has a perfected security interest, that has a quantifiable value, and is accepted by the lender in accordance with safe and sound lending practices. Other acceptable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral. Other acceptable collateral includes, among other items, unconditional irrevocable standby letters of credit for the benefit of the lender.

*Owner-occupied*, when used in conjunction with the term *1- to 4-family residential property* means that the owner of the underlying real property occupies at least one unit of the real property as a principal residence of the owner.

*Readily marketable collateral* means insured deposits, financial instruments, and bullion in which the lender has a perfected interest. Financial instruments and bullion must be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, on an auction or similarly available daily bid and ask price market. Readily marketable collateral should

be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral.

*Value* means an opinion or estimate, set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agency's appraisal regulations and guidance. For loans to purchase an existing property, the term "value" means the lesser of the actual acquisition cost or the estimate of value.

*1- to 4-family residential property* means property containing fewer than five individual dwelling units, including manufactured homes permanently affixed to the underlying property (when deemed to be real property under state law).

#### **§ 560.110 Most favored lender usury preemption.**

(a) *Definition.* The term "interest" as used in 12 U.S.C. 1463(g) includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

(b) *Authority.* A savings association located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a federal savings association making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a federal savings association may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies. Except as provided in this paragraph, the applicability of state law to Federal savings associations shall be determined in accordance with § 560.2 of this part. State supervisors determine the degree to which state-chartered savings associations must comply with state laws other than those imposing restrictions on interest, as defined in paragraph (a) of this section.

(c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a savings association is located but state law permits its most favored lender to charge late fees, then a savings association located in that state may charge late fees to its intrastate customers. The savings association may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the savings association is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

#### **§ 560.120 Letters of credit and other independent undertakings to pay against documents.**

(a) *General authority.* To the extent that it has legal authority to do so, a savings association may issue and commit to issue letters of credit within the scope of applicable laws or rules of practice recognized by law.<sup>1</sup> It may also issue other independent undertakings within the scope of such laws or rules of practice recognized by law, that have been approved by OTS (approved undertaking). Under such letters of credit and approved undertakings, the savings association's obligation to honor depends upon the presentation of specified documents and not upon nondocumentary conditions or resolution of questions of fact or law at issue between the account party and the beneficiary. A savings association may also confirm or otherwise undertake to honor or purchase specified documents

<sup>1</sup> Samples of laws or rules of practice applicable to letters of credit and other independent undertakings include, but are not limited to: the applicable version of Article 5 of the Uniform Commercial Code (UCC) (1962, as amended 1990) or revised Article 5 of the UCC (as amended 1995) (available from West Publishing Co., 1/800/340-9378); the Uniform Customs and Practice for Documentary Credits (International Chamber of Commerce (ICC) Publication No. 500) (available from ICC Publishing, Inc., 212/206-1150); the United Nations Commission on International Trade Law (UNCITRAL) Convention on Independent Guarantees and Standby Letters of Credit (adopted by UNCITRAL 1995) (available from UNCITRAL, 212/963-5353); and the Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits (ICC Publication No. 525) (available from ICC Publishing, Inc., 212/206-1150); as any of the foregoing may be amended from time to time.

upon their presentation under another person's independent undertaking within the scope of such laws or rules.

(b) *Safety and soundness considerations.*—(1) *Terms.* As a matter of safe and sound banking practice, savings associations that issue letters of credit or approved undertakings should not be exposed to undue risk. At a minimum, savings associations should consider the following:

(i) The independent character of the letter of credit or approved undertaking should be apparent from its terms (such as terms that subject it to laws or rules providing for its independent character);

(ii) The letter of credit or approved undertaking should be limited in amount;

(iii) The letter of credit or approved undertaking should:

(A) Be limited in duration; or

(B) Permit the savings association to terminate the letter of credit or approved undertaking, either on a periodic basis (consistent with the savings association's ability to make any necessary credit assessments) or at will upon either notice or payment to the beneficiary; or

(C) Entitle the savings association to cash collateral from the account party on demand (with a right to accelerate the customer's obligations, as appropriate); and

(iv) The savings association either should be fully collateralized or have a post-honor right of reimbursement from its customer or from another issuer of a letter of credit or an independent undertaking. Alternatively, if the savings association's undertaking is to purchase documents of title, securities, or other valuable documents, it should obtain a first priority right to realize on the documents if the savings association is not otherwise to be reimbursed.

(2) *Additional considerations in special circumstances.* Certain letters of credit and approved undertakings require particular protections against credit, operational, and market risk:

(i) In the event that the undertaking is to honor by delivery of an item of value other than money, the savings association should ensure that market fluctuations that affect the value of the item will not cause the savings association to assume undue market risk;

(ii) In the event that an undertaking provides for renewal, the terms for renewal should be consistent with the savings association's ability to make any necessary credit assessments prior to renewal; and

(iii) In the event that a savings association issues an undertaking for its own account, the underlying transaction

for which it is issued must be within the savings association's authority and comply with any safety and soundness requirements applicable to that transaction.

(3) *Operational expertise.* The savings association should possess operational expertise that is commensurate with the sophistication of its letter of credit or independent undertaking activities.

(4) *Documentation.* The savings association must accurately reflect its letters of credit or approved undertakings in its records, including any acceptance or deferred payment or other absolute obligation arising out of its contingent undertaking.

#### **§ 560.121 Investment in state housing corporations.**

(a) Any savings association to the extent it has legal authority to do so, may make investments in, commitments to invest in, loans to, or commitments to lend to any state housing corporation; provided, that such obligations or loans are secured directly, or indirectly through a fiduciary, by a first lien on improved real estate which is insured under the National Housing Act, as amended, and that in the event of default, the holder of such obligations or loans has the right directly, or indirectly through a fiduciary, to subject to the satisfaction of such obligations or loans the real estate described in the first lien, or the insurance proceeds.

(b) Any savings association that is adequately capitalized may, to the extent it has legal authority to do so, invest in obligations (including loans) of, or issued by, any state housing corporation incorporated in the state in which such savings association has its home or a branch office; provided (except with respect to loans), that:

(1) The obligations are rated in one of the four highest grades as shown by the most recently published rating made of such obligations by a nationally recognized rating service; or

(2) The obligations, if not rated, are approved by the Office. The aggregate outstanding direct investment in obligations under paragraph (b) of this section shall not exceed the amount of the savings association's total capital.

(c) Each state housing corporation in which a savings association invests under the authority of paragraph (b) of this section shall agree, before accepting any such investment (including any loan or loan commitment), to make available at any time to the Office such information as the Office may consider to be necessary to ensure that investments are properly made under this section.

#### **§ 560.160 Asset classification.**

(a) (1) Each savings association shall evaluate and classify its assets on a regular basis in a manner consistent with, or reconcilable to, the asset classification system used by OTS in its Thrift Activities Handbook (Available at the address listed in § 516.1 of this chapter).

(2) In connection with the examination of a savings association or its affiliates, OTS examiners may identify problem assets and classify them, if appropriate. The association must recognize such examiner classifications in its subsequent reports to OTS.

(b) Based on the evaluation and classification of its assets, each savings association shall establish adequate valuation allowances or charge-offs, as appropriate, consistent with generally accepted accounting principles and the practices of the federal banking agencies.

#### **§ 560.170 Records for lending transactions.**

In establishing and maintaining its records pursuant to § 563.170 of this chapter, each savings association and service corporation should establish and maintain loan documentation practices that:

(a) Ensure that the institution can make an informed lending decision and can assess risk on an ongoing basis;

(b) Identify the purpose and all sources of repayment for each loan, and assess the ability of the borrower(s) and any guarantor(s) to repay the indebtedness in a timely manner;

(c) Ensure that any claims against a borrower, guarantor, security holders, and collateral are legally enforceable;

(d) Demonstrate appropriate administration and monitoring of its loans; and

(e) Take into account the size and complexity of its loans.

#### **§ 560.172 Re-evaluation of real estate owned.**

A savings association shall appraise each parcel of real estate owned at the earlier of in-substance foreclosure or at the time of the savings association's acquisition of such property, and at such times thereafter as dictated by prudent management policy; such appraisals shall be consistent with the requirements of part 564 of this chapter. The Regional Director or his or her designee may require subsequent appraisals if, in his or her discretion, such subsequent appraisal is necessary under the particular circumstances. The foregoing requirement shall not apply to any parcel of real estate that is sold and

reacquired less than 12 months subsequent to the most recent appraisal made pursuant to this part. A dated, signed copy of each report of appraisal made pursuant to any provisions of this part shall be retained in the savings association's records.

### Subpart C—Alternative Mortgage Transactions

#### § 560.210 Disclosures for adjustable-rate mortgage loans, adjustment notices, and interest-rate caps.

(a) *Definitions.* For purposes of this section:

(1) *Adjustable-rate mortgage loan* means a mortgage loan, secured by property occupied or to be occupied by the borrower, providing for adjustments to the interest rate which cause a change in balance, term to maturity, or payment levels other than those established by a fixed, predetermined schedule at the time of contracting for the loan.

(2) [Reserved]

(3) *Applicant* means a natural person (or persons) making a loan application.

(4) *Home* means real estate as defined by § 541.14 of this chapter, manufactured housing, combinations of homes and business property, and farm residences or combinations of farm residences and commercial farm real estate.

(b) *Initial disclosures for adjustable-rate mortgage loans.* Savings associations offering adjustable-rate home loans, except open-end loans, with a term of more than one (1) year and secured by property occupied or to be occupied by the borrower, shall provide two types of written disclosure to prospective borrowers when an application form is provided or before the payment of a non-refundable fee, whichever is earlier:

(1) The booklet titled *Consumer Handbook on Adjustable Rate Mortgages* published by the Office and the Federal Reserve Board, or a suitable substitute (Available at the address listed in § 516.1 of this chapter.).

(2) A loan program disclosure for each adjustable-rate home loan program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:<sup>2</sup>

(i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be

determined, including an explanation of how the index is adjusted, such as by the use of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) An historical example, based on a \$10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. The example shall be based upon index values beginning in 1977 and be updated annually until a 15-year history is shown. Thereafter, the example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limitations, that would have been affected by the index movement during the period.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.

(x) The maximum interest rate and payment for a \$10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan.

(xi) The fact that the loan program contains a demand feature.

(xii) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xiii) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

(c) *Adjustment notices.* An adjustment to the interest rate with or without a corresponding adjustment to the payment in an adjustable-rate transaction subject to this section is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar

days before a payment at a new level is due, the following written disclosures, as applicable, must be delivered or placed in the mail:

(1) The current and prior interest rates.

(2) The index values upon which the current and prior interest rates are based.

(3) The extent to which the creditor has foregone any increase in the interest rate.

(4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance.

(5) The payment, if different from that referred to in paragraph (c)(4) of this section, that would be required to amortize fully the loan at the new interest rate over the remainder of the loan term.

(d) [Reserved]

(e) *Maximum interest rate caps.* All savings associations making adjustable-rate loans, originated on or after December 8, 1987, whether open-end or closed-end, shall comply with Regulation Z (12 CFR 226.30) by specifying in their credit contracts the maximum interest rate that may be imposed during the term of the obligation.

(f) *Exception.* The disclosures in paragraph (b) of this section are not required in connection with the extension of consumer credit as defined in § 561.12 of this chapter even if it is secured by a borrower-occupied home as long as the home is not the primary security for the loan.

(g) *Exempt transactions.* This section does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose.

#### § 560.220 Alternative Mortgage Parity Act.

Pursuant to 12 U.S.C. 3803, housing creditors that are not commercial banks, credit unions, or Federal savings associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 U.S.C. 3801 note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable.

<sup>2</sup> A sample disclosure form may be found in the Federal Register issue of May 23, 1988 (53 FR 18262) or may be obtained from the Office at the address listed in § 516.1 of this chapter.

**PART 563—OPERATIONS**

10. The authority citation for part 563 continues to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1828, 3806.

**§ 563.51 [Amended]**

11. Section 563.51(f)(1)(i) is amended by removing the phrase “§ 545.45(a)(1)”, and by adding in lieu thereof the phrase “§ 560.30”.

**Subpart D of Part 563—[Removed and Reserved]**

12. Subpart D of part 563 is removed and reserved.

**§ 563.160 [Removed]**

13. Section 563.160 is removed.

14. Section 563.170 is amended by revising paragraph (c) to read as follows:

**§ 563.170 Examinations and audits; appraisals; establishment and maintenance of records.**

\* \* \* \* \*

(c) *Establishment and maintenance of records.* To enable the Office to examine savings associations and affiliates and audit savings associations, affiliates, and service corporations pursuant to the provisions of paragraph (a) of this section, each savings association, affiliate, and service corporation shall establish and maintain such accounting and other records as will provide an accurate and complete record of all business it transacts. This includes, without limitation, establishing and maintaining such other records as are required by statute or any other regulation to which the savings association, affiliate, or service corporation is subject. The documents, files, and other material or property comprising said records shall at all times be available for such examination and audit wherever any of said records, documents, files, material, or property may be.

\* \* \* \* \*

**§ 563.172 [Removed]**

15. Section 563.172 is removed.

**PART 566—LIQUIDITY**

16. The authority citation for part 566 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1465, 1467a; 15 U.S.C. 1691, 1691a.

**§ 566.1 [Amended]**

17. Section 566.1(g)(6)(i) is amended by removing the phrase “§ 545.72(a)”, and by adding in lieu thereof the phrase “§ 560.42”.

**PART 571—STATEMENTS OF POLICY**

18. The authority citation for part 571 continues to read as follows:

Authority: 5 U.S.C. 552, 559; 12 U.S.C. 1462a, 1463, 1464.

**§§ 571.8, 571.13, 571.20, 571.22 [Removed]**

19. Sections 571.8, 571.13, 571.20, and 571.22 are removed.

**PART 590—PREEMPTION OF STATE USURY LAWS**

20. The authority citation for part 590 continues to read as follows:

Authority: 12 U.S.C. 1735f–7a.

**§ 590.4 [Amended]**

21. Section 590.4(e)(1) is amended by removing the phrase “§ 545.33(f)”, and by adding in lieu thereof the phrase “§ 560.220”.

Dated: September 11, 1996.

By the Office of Thrift Supervision.

John F. Downey,

*Executive Director, Supervision.*

[FR Doc. 96–23726 Filed 9–27–96; 8:45 am]

BILLING CODE 6720–01 P

**DEPARTMENT OF TRANSPORTATION****Federal Aviation Administration****14 CFR Part 39**

[Docket No. 95–ANE–37; Amendment 39–9732; AD 96–18–08]

**Airworthiness Directives; Pratt & Whitney PW2000 Series Turbofan Engines**

**AGENCY:** Federal Aviation Administration, DOT.

**ACTION:** Final rule.

**SUMMARY:** This amendment adopts a new airworthiness directive (AD), applicable to Pratt & Whitney PW2000 series turbofan engines, that requires a reduction in the cyclic service life limit for hubs, disks, airseals, blade retaining plates, and airsealing ring supports on certain high pressure turbines (HPT) and low pressure turbines (LPT), and provides for optional inspections for cracks or rework of certain HPT and LPT hardware in order to retain the original, higher cyclic service life limit for these components. This amendment is prompted in part by new temperature data from engine testing, which were used in recalculating stress levels, and resulted in a change to the calculated cyclic service life limit. The actions specified by this AD are intended to prevent HPT or LPT failure, which may result in an uncontained engine failure and possible damage to the aircraft.

**DATES:** Effective November 29, 1996.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of November 29, 1996.

**ADDRESSES:** The service information referenced in this AD may be obtained from Pratt & Whitney, Publications Department, Supervisor Technical Publications Distribution, M/S 132–30, 400 Main St., East Hartford, CT 06108; telephone (860) 565–7700, fax (860) 565–4503. This information may be examined at the Federal Aviation Administration (FAA), New England Region, Office of the Assistant Chief Counsel, 12 New England Executive Park, Burlington, MA; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC. **FOR FURTHER INFORMATION CONTACT:** John Fisher, Aerospace Engineer, Engine Certification Office, FAA, Engine and Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803–5299; telephone (617) 238–7149, fax (617) 238–7199.

**SUPPLEMENTARY INFORMATION:** A proposal to amend part 39 of the Federal Aviation Regulations (14 CFR part 39) to include an airworthiness directive (AD) that is applicable to Pratt & Whitney PW2000 series turbofan engines was published in the Federal Register on October 16, 1995 (60 FR 53554). That action proposed to require a reduction in the cyclic service life limit for hubs, disks, airseals, blade retaining plates, and airsealing ring supports on certain HPT and LPT hardware, and provide for optional inspections for cracks or rework of certain HPT and LPT hardware in order to retain the original, higher cyclic service life limit for these components.

Interested persons have been afforded an opportunity to participate in the making of this amendment. Due consideration has been given to the comments received.

One commenter states that the AD should be withdrawn. The commenter states that life reductions are already provided in Chapter 05 of the Engine Manual, thereby mandating the appropriate part lives. Furthermore, the commenter states that by mandating the SBs in the AD, all standard practices referenced within these SBs become mandated, so that the overhaul shops will be required to obtain multiple alternative methods of compliance, since their shop practices may be different than those referenced in the AD. The FAA does not concur. Service life limits that appear as airworthiness limitations at the time of type-