Approved February 1, 1983
Date

MINUTES OF THE Senate COMMITTEE ON Commercial and Financial Insitutions.

The meeting was called to order by Sen. Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on January 27, 1983 in room 529-S of the Capitol.

All members were present except:

Senators Hess and Harder - Excused

Committee staff present:

Bill Wolff, Legislative Research
Myrta Anderson, Legislative Research
Bruce Kinzie, Revisor's Office

Conferees appearing before the committee:

Ron Todd, Insurance Commissioner's Office
Jim Turner, Kansas Savings and Loan League
Marvin Umholtz, Kansas Credit Union League
Jim Maag, Kansas Bankers Association

The minutes of January 26 were approved.

Ron Todd, Insurance Commissioner's Office, appeared to request that five bills be introduced. (See Attachment I). Mr. Todd gave a brief explanation of each of the proposed bills.

Sen. Werts made a motion to introduce and refer back to the committee all five of the bills. Sen. Pomeroy seconded the motion. The motion carried.

The hearing on SB 50 began with the testimony of Jim Turner, Kansas Savings and Loan League. (See Attachment II). Sen. Feleciano asked how SB 50 differs from the House bill dealing with the same subject. Jim Maag, Kansas Bankers Association, answered for Mr. Turner saying that SB 50 repeals 16-207d to clarify that the adjustable rate index and the state regulations would refer only to residential adjustable rate real estate loans and not to commercial and agricultural loans. Sen. Pomeroy pointed out to the committee the possibility of some confusion resulting from having this bill, being so similar to the one in the House, introduced. Committee discussion followed concerning the difference between the House bill and SB 50 with staff offering explanations.

Marvin Umholtz, Kansas Credit Union League, appeared to give his testimony on SB 50. (See Attachment III). He also passed out copies of HB 2071 which deals with the same subject but specifically exempts agriculture and business loans. (See Attachment IV). After some questions from the chairman, Mr. Umholtz's testimony was concluded.

Jim Maag, Kansas Bankers Association, gave his testimony on SB 50. (See Attachment V). After committee discussion and contributions from staff, the hearing on SB 50 was concluded.

All of the conferees on SB 50 support it, but if it is not passed, they would support the concept of HB 2071.

The next meeting will be held on February 1.

The meeting was adjourned.

SENATE COMMITTEE

ON

COMMERCIAL AND FINANCIAL INSTITUTIONS

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
	M. Hawver	Topeka	Capital-Journal
	Mark Burnett	Topeka	A J A
	Ed Johnson	"	Kan Assn of Sav & Loan
	Carl R. Sanderstrom	"	Banking Dept
	Janet Stubbs	"	KBAK
	Merna Schultz	"	KOAL
	LARRY MAGILL	"	I. I. A. K.
	Jim Turner	Topeka	KSLL
	Tom Wilder	"	KSLL
	Connie Jacoby	Lawrence	Sen. Rehorn
	Dick Brock	Topeka	Ins Dept

EXPLANATORY MEMORANDUM FOR
LEGISLATIVE PROPOSAL NO. 7

Historically, insurance companies have been subject to limitations on the kind and amount of investment opportunities they can engage in. Generally, these limitations have been intended to serve two purposes. First, they were designed to promote investments in property that can be readily converted to cash in order that insurers would be in a constant state of readiness with respect to payment of claims. Second, such limitations have been designed to buttress financial solvency by not permitting investments in overly speculative type of ventures or by placing too large a portion of the company's assets in a single kind of investment medium. These limitations have served their purpose quite well and, as a result, the insuring public has been the beneficiary of an insurance industry that, on an overall basis, has been financially stable.

Legislative Proposal No. 7 does not depart from this historic philosophy. At the same time, however, it recognizes that investment opportunities are constantly changing. It further recognizes that financial institutions are becoming increasingly competitive and that the traditional distinctions that have separated one kind of financial institution from another are disappearing. In one way or another, directly or indirectly, the kinds of products that are available from insurance companies and the price the customers of insurance companies will pay for their products is inextricably influenced by the return insurance companies earn on their investments. As a result, the public would be poorly served by a demand on the part of regulators or legislators that insurance companies be forever tied to overly stringent investment restrictions.

Legislative Proposal No. 7 addresses the changing investment environment by lessening current restrictions; permitting investments in securities not previously specified in the insurance investment statutes, and by recognizing the value of assets already owned by insurance companies but not previously permitted to be treated as a bona fide asset because of insurance accounting principles. As a result enactment of this proposal will permit Kansas domiciled insurance companies to better compete for tomorrow's investment dollars without endangering their ability to meet today's obligations.

The Senate Commercial and Financial Institutions Committee will be requested to introduce this proposal.

Attachment I a

LEGISLATIVE PROPOSAL NO. 7

AN ACT relating to insurance; concerning life insurance companies and other than life insurance companies; relating to investments, amending K.S.A. 40-2b06, 40-2b07, 40-2b09, 40-2b10, 40-2b13, 40-2b20, 40-2a08, 40-2a09, 40-2a12, 40-2a13 and 40-2a16, and repealing the existing sections.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF KANSAS:

Section 1. K.S.A. 40-2b06 is hereby amended to read as follows: 40-2b06. Any life insurance company heretofore or hereafter organized under any law of this state may invest by loans or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in preferred stocks of, or stocks guaranteed by, a corporation incorporated under the laws of the United States of America, or of any state, district, insular or territorial possession thereof; or of the Dominion of Canada, or any province thereof; in an amount not to exceed ~~twenty-percent-(20%)~~ twenty-five percent (25%) of its admitted assets as shown by the company's last annual report, as filed with the state commissioner of insurance, and which meets the following qualifications:

(a) All bonds or other evidences of indebtedness and preferred stocks shown on the last published annual statement of the issuing corporation, if any, senior to the preferred stock acquired must be eligible as investments under K.S.A. 40-2b05 or 40-2b06 as of the date of acquisition;

(b) if cumulative preferred, not in arrears as to dividends, or if noncumulative, has paid full dividends in each of the last three (3) years;

(c) sinking fund payments are on a current basis;

(d) if net earnings available for fixed charges for the most recently completed three fiscal year period is at least equal to one and one-quarter (1¼) times the aggregate fixed charges, plus full contingent interest and preferred dividend requirements of the preferred stock under consideration and those on a parity therewith or having a priority thereto, for the same period; and

(e) the corporation must have been in existence for a period of not less than five (5) years.

Definitions: (a) "Fixed charges" shall include actual interest incurred in each year on funded and unfunded debt;

(b) "net earnings" shall mean income, before deducting interest on funded and unfunded debt, and after deducting operating and maintenance expenses, depreciation and depletion, and all taxes (including income taxes). Extraordinary, nonrecurring items of income or expenses shall be excluded.

Sec. 2. K.S.A. 40-2b07 is hereby amended to read as follows: 40-2b07. Any life insurance company heretofore or hereafter organized under any law of this state may invest by loans or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in the common stock of any corporation organized and doing business under the laws of the United States or any state, or of the District of Columbia, or of the Dominion of Canada, or any province of the Dominion of Canada, in an amount, based upon cost, not exceeding ~~ten-percent-(10%)~~ fifteen percent (15%) of its admitted assets or not exceeding the combined capital and surplus, whichever is the lesser, as shown by the company's last annual report. Such life insurance company may write exchange traded, covered call options on shares it owns and may purchase call options for the sole purpose of closing out a position taken previously with respect to one or more options having been written. The purchase of a call option for any reason other than as a closing transaction and the writing of naked (uncovered) call options are hereby prohibited. Investments in common stocks and the writing of call options shall be further limited as follows:

(a) The obligations and preferred stock, if any, shown on the last published annual statement of such corporation must be eligible for investment under K.S.A. 40-2b05 or 40-2b06;

(b) cash dividends have been paid during each of the last three (3) years preceding the date of acquisition;

(c) the stock is registered with a national securities exchange regulated under the securities exchange act of 1934, as amended, or is regularly traded on a national or regional basis ~~.-or-is-that-of-a-corporation-registered-and-operated-as-an-open-end-regulated-investment-company-in-accordance-with-the-investment-company-act-of-1940,-as-amended;-~~

(d) The company shall have earnings in three (3) of the last five (5) years preceding the date of acquisition;

(e) at no time shall an insurance company invest in more than five percent (5%) of the total number of the outstanding shares of any one such corporation, nor an amount more than two percent (2%) of the investing insurance company's admitted assets in shares of any one such corporation (determined on the basis of the cost of such shares to the insurance company at time of purchase). ~~With the approval of the commissioner of insurance, a company may acquire in excess of five percent (5%) of the outstanding shares of another insurance company;~~

(f) stock owned by an insurance company that is obligated under an unexpired written call option shall be valued at the lesser of the striking price or current market value. For the purposes of this subsection, "striking price" means the price per share, exclusive of selling costs, the company would receive should the call option be exercised by the holder.

Sec. 3. K.S.A. 40-2b09 is hereby amended to read as follows: 40-2b09. Any life insurance company heretofore or hereafter organized under any law of this state may invest by loans or otherwise with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in:

(a) Bonds, notes, obligations or other evidences of indebtedness secured by mortgages or deeds of trust which are a first lien upon unencumbered real property and appurtenances thereto within the United States of America, or any insular or territorial possession of the United States, or the Dominion of Canada, and upon leasehold estates in real property wherein the term of such including any options to extend is not less than fifteen (15) years beyond the maturity of the loan as made or extended: ~~Provided, That~~ At the date of acquisition the total indebtedness secured by such lien shall not exceed ~~seventy five percent (75%)~~ eighty percent (80%) of the market value of the property upon which it is a lien, unless that portion of the total indebtedness in excess of ~~seventy five percent (75%)~~ eighty percent (80%) of market value is insured by a mortgage insurance company authorized by the commissioner of insurance to do business in this state. These limitations shall not apply to obligations described in subsections (b), (c), (d), (e) and (f) of this section: ~~And provided further, That~~ For the purpose of this section a mortage or deed of trust shall not be deemed to be other than a first lien upon property within the meaning of this section by reason of the existence of taxes or assessments against real property and appurtenances thereto that are not delinquent, instruments creating or reserving mineral, oil, or timber rights, rights-of-way, joint driveways, sewer rights, rights in walls or by reason of building restrictions or other like restrictive covenants, or when such real estate is subject to lease in whole or in part whereby rents or profits are reserved to the owner or when there is in existence a fixed obligation or lien against the property where an escrow account or indemnification bond is or has been established or obtained sufficient to cover the maximum liability created by such obligation or lien;

(b) bonds, notes, or other evidences of indebtedness representing loans and advances of credit that have been issued, guaranteed or insured by the United States government or an agency or instrumentality thereof or insured by any insurance company authorized to transact such business in this state: Provided, That any uninsured or nonguaranteed portion shall not exceed ~~seventy five percent (75%)~~ eighty percent (80%) of the total amount;

(c) contracts of sale, purchase money mortgages or deeds of trust secured by property obtained through foreclosure, or in settlement or satisfaction of any indebtedness;

(d) bonds, notes, obligations, or other evidences of indebtedness secured by mortgages or deeds of trust which are a first lien upon unencumbered personal or real or both personal and real property, including a leasehold of real estate, under lease, purchase contract, or lease purchase contract to any governmental body or instrumentality whose obligations qualify under K.S.A. 40-2b01, 40-2b02 or 40-2b03 or to a corporation whose obligations qualify under K.S.A. 40-2b05: Provided, There is adequate rental, after making allowance of lessors' or sellers' obligations and liabilities, if any, under the terms of said lease or contract, to retire the loan as to payments of principal and interest: And provided further, That the rentals are pledged or assigned to the lender;

(e) bonds, notes or other evidences of indebtedness representing loans and advances of credit that have been issued, guaranteed or insured, in accordance with the terms and provisions of an act of the federal parliament of the Dominion of Canada approved March 18, 1954, cited as the "national housing act, 1954," as heretofore and hereafter amended.

(f) Participation in mortage lending is specifically permitted in this section as between Kansas domiciled life insurance companies, or, between Kansas domiciled life insurance companies and life insurance companies organized under the laws of another country, state, or territory and authorized to do business in the state of Kansas, or,

between Kansas domiciled life insurance companies and/or banks, trust companies or savings and loan associations located within the state of Kansas, upon unencumbered real property and appurtenances thereto: Provided, That at the date of acquisition the total indebtedness assumed by such lien should not exceed ~~seventy-five percent (75%)~~ eighty percent (80%) of the market value of the property upon which it is a lien, unless that portion of the total indebtedness in excess of ~~seventy-five percent (75%)~~ eighty percent (80%) of market value is insured by a mortgage insurance company authorized by the commissioner of insurance to do business in this state.

(g) First mortgage or deeds of trust upon improved real property to be occupied as a personal residence by an officer of the insurer, if said mortgage is at an interest rate that is reasonably competitive with that charged by the other lending institutions in the community. Mortgages or deeds of trust entered into pursuant to this subsection shall be subject to the conditions set forth in subsection (a) of this section relating to mortgages or deeds of trust generally.

Sec. 4. K.S.A. 40-2b10 is hereby amended to read as follows: 40-2b10. No life insurance company organized under the laws of this state shall purchase, hold or convey real estate, excepting for the purposes and in the manner herein set forth:

(a) Such as shall be requisite for its convenient present and future accommodation in the transaction of its business. In the erection or purchase of any buildings for such purpose, additional space may be included for home office rental income;

(b) such as shall have been mortgaged to it in good faith, by way of security for loans previously contracted or for money due;

(c) such as shall have been conveyed to it in satisfaction of debts previously contracted in their legitimate business, or for money due;

(d) such as shall have been purchased at sales upon judgments, decrees or mortgages obtained or made for such debts; or

(e) such as shall have been acquired for development or income purposes.

It shall not be lawful for any such company to purchase, hold or convey real estate in any other case or for any other purpose, except nothing in this section shall be deemed to prohibit any such company for purchasing the principal residence owned and inhabited by an employee or prospective employee who is being transferred by the company to a different community; and all such real estate as may be acquired as aforesaid, and which shall not be necessary for the accommodation of such company in the transaction of its business, excepting real estate acquired for development or income purposes, shall be sold and disposed of within five years after such company shall have acquired title thereto, unless the company shall procure a certificate from the commissioner of insurance that the interests of the company will suffer materially by a forced sale thereof in which event the sale may be postponed for such period as the commissioner of insurance shall direct in such certificate. If the company so elects, real estate other than farm properties, which has been acquired under subsections (c) and (d) of this section may be held by it for income purposes . ~~if its value together with that of all other real estate owned by the company at the time of such election does~~ The company's aggregate investment in real estate as herein provided shall not exceed ~~10%~~ 20% of the admitted assets of the company, as shown by its last annual report as filed with the state commissioner of insurance.

Sec. 5. K.S.A. 40-2b13 is hereby amended to read as follows: 40-2b13. Any life insurance company heretofore or hereafter organized under any law of this state may invest by loans or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in investments whether or not qualified and permitted under this act and notwithstanding any conditions or limitations prescribed therein, except those which require that a corporation be solvent and not have defaulted with respect to the payment of principal or interest, and subject to the provisions of K.S.A. 17-3004, in an aggregate amount not more than ~~five percent (5%)~~ ten percent (10%) of its admitted assets as shown by the company's last annual report as filed with the state insurance commissioner.

Sec. 6. K.S.A. 40-2b20 is hereby amended to read as follows: 40-2b20. (a) Any life insurance company heretofore or hereafter organized under any law of this state, with the direction or approval of a majority of its board of directors and approval of the commissioner of insurance, may designate a state or national bank, having trust powers, ~~and having its principal place of business in this state,~~ as trustee to make any investment authorized by this act in the name of the trustee or nominee as a trustee or nominee.

Sec. 7. K.S.A. 40-2a08 is hereby amended to read as follows: 40-2a08. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in the

common stock of any corporation organized and doing business under the laws of the United States of America, or of any state, district, insular or territorial possession thereof; or of the Dominion of Canada or any province thereof; or of any other country or subdivision thereof; ~~and the shares of a management type of investment company or investment trust registered with the securities and exchange commission under the investment company act of 1940, as amended.~~ Such insurance company may write exchange traded, covered call options on shares it owns and may purchase call options for the sole purpose of closing out a position taken previously with respect to one or more options having been written. The purchase of a call option for any reason other than as a closing transaction and the writing of naked (uncovered) call options are hereby prohibited. Investments in common stocks and the writing of call options shall be further limited as follows:

(a) The obligations and preferred stock, if any, shown on the last published annual statement of such corporation must be eligible for investment under K.S.A. 40-2a05 or 40-2a07;

(b) cash dividends have been paid during each of the last three (3) years preceding the date of acquisition;

(c) the stock is registered with a national securities exchange regulated under the securities exchange act of 1934, as amended, or is regularly traded on a national or regional basis~~, or is a corporation registered and operated as an open end regulated investment company in accordance with the investment company act of 1940, as amended~~;

(d) the company shall have earnings in three (3) of the last five (5) years preceding the date of acquisition;

(e) investments in common stock in any one corporation shall at no time exceed two percent (2%) of the admitted assets of the investing insurance company, and at no time shall an insurance company purchase more than five percent (5%) of the outstanding shares of stock of any one given corporation;

~~(f) investments in shares of a management type of investment company or registered investment trust as described above, shall have assets of not less than twenty five million dollars ($25,000,000) at the date of purchase, and subsections (a), (b), (c), (d) and (e) of this section need not apply;~~

~~(g)~~ (f) the amount invested under this section, including the amount invested under K.S.A. 40-2a07, excluding stock of any insurance company qualified under K.S.A. 40-2a09, shall not exceed the excess of surplus as regards policyholders over one hundred thousand dollars ($100,000);

~~(h)~~ (g) stock owned by an insurance company that is obligated under an unexpired written call option shall be valued at the lesser of the striking price or current market value. For the purposes of this subsection, "striking price" means the price per share, exclusive of selling costs, the company would receive should the call option be exercised by the holder.

New Sec. 8. Any life insurance company heretofore or hereafter organized under any law of this state may invest by loans or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in the purchase of fixed wing aircraft, electric or mechanical machines constituting a word processing system, motor vehicles, and personal property used as a substitute for or in lieu of improvements upon real property such as detached modular partition systems, and thereafter may hold such assets as admitted assets for use in connection with the business of the company if, (1) the asset or asset system shall have a cost of not less than two thousand five hundred dollars ($2,500) and such assets aggregate shall not, irrespective of K.S.A. 40-2b13, exceed five percent (5%) of the admitted assets of the company; (2) the cost of each asset or system shall be fully amortized over a reasonable period not to exceed ten (10) years. If an asset consists of separate but inter-dependent components each component shall be amortized over a reasonable period not to exceed ten (10) years commencing with the date of acquisition of each component. Personal property investments are not deemed eligible for deposit under K.S.A. 40-404 and shall not be included in the admitted assets for purposes of complying with minimum capital, surplus, or capital and surplus requirements applicable to issuance or continuation of a certificate of authority.

New Sec. 9. Any life insurance company heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in: (a) Stock in any insurance company, subsection (c) of K.S.A. 40-2b07 notwithstanding. Before more than 5% of the outstanding shares of stock of any insurance company is acquired, or a tender offer made thereof, prior written approval of the commissioner of insurance must be secured;

(b) stock in an incorporated insurance agency: (1) If 5% or less of the outstanding shares of such incorporated agency is acquired, the provisions of K.S.A. 40-2b07 shall apply; (2) if more than 5% of the outstanding shares of such incorporated agency is acquired, or a tender offer is made therefor, the prior approval of the commissioner of insurance shall be required and the provisions of subsection (d) of K.S.A. 40-2b07 shall apply. Invaluing the stock of the agency, the assets of the agency shall be valued as if held directly by an insurance company; and (3) if majority interest in an incorporated insurance agency results from the organization of an agency by the insurance company to which this act applies, such investments shall be subject to the provisions of K.S.A. 40-2b13 until it has produced earnings for three out of five consecutive years. Such stock shall not be eligible for deposit with the commissioner of insurance as part of the legal reserve of such insurance company;

(c) stock in a holding corporation: (1) If 5% or less of the outstanding shares of stock of such holding corporation is acquired, the provisions of K.S.A. 40-2b07 shall apply; (2) if at least 75% of the holding corporation's voting stock is acquired, the prior approval of the commissioner of insurance shall be required and the provisions of K.S.A. 40-2b07 shall not apply. No insurer may purchase in excess of 5% of the outstanding voting stock of a holding corporation unless such insurer acquires at least 75% of such stock. The commissioner of insurance may direct an insurer to divest of its ownership in a holding corporation acquired pursuant to this subsection if it appears to the commissioner that the continued ownership or operation of the holding corporation is not in the best interest of the policyholders, or if the insurer's ownership in the holding corporation is less than 75% of the outstanding voting stock of the holding corporation. A holding corporation acquired pursuant to this subsection shall not acquire any investment not permitted for life insurance companies pursuant to article 2b of chapter 40 of the Kansas Statutes Annotated. In valuing the stock of any holding corporation acquired under this subsection in the annual financial statement of the insurer, value shall be assigned to the holding corporation's assets as though the assets were owned directly by the insurer. A percentage of the holding corporation's assets exactly equal to the insurer's ownership interest in the holding corporation will be added to the assets of the insurer in application of the insurer's investment limitations set forth in article 2b of chapter 40 of the Kansas Statutes Annotated. Stock in a holding corporation acquired under this subsection shall not be eligible for deposit with the commissioner of insurance as part of the legal reserves of such insurer.

New Sec. 10. Any life insurance company heretofore or hereafter organized under any laws of this state may invest, in addition to any other investments permitted by this act, by laws or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in shares of a corporation registered and operated as an open-end regulated investment company in accordance with the investment company act of 1940, as amended. Investments under this section shall be further limited as follows: (a) The insurance company's aggregate investment under this provision shall not exceed 10% of its admitted assets as shown by the company's last annual report as filed with the state commissioner of insurance.

(b) The investment company in which the insurance company acquires shares shall have assets of not less than $25,000,000 at the date of purchase.

(c) The insurance company shall not acquire more than 5% of the outstanding shares of any one investment company.

(d) Investments in the shares of any one investment company shall not exceed 2% of the admitted assets of the insurance company as shown by the company's last annual report as filed with the state commissioner of insurance (determined on the basis of the cost of such shares to the insurance company at time of purchase).

New Sec. 11. Any insurance company other than life heretofore or hereafter organized under any laws of this state may invest, in addition to any other investments permitted by this act, by laws or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in shares of a corporation registered and operated on an open-end regulated investment company in accordance with the investment company act of 1940, as amended. Investments under this section shall be further limited as follows: (a) The insurance company's aggregate investment under this provision shall not exceed 10% of its admitted assets as shown by the company's last annual report as filed with the state commissioner of insurance.

(b) The investment company in which the insurance company acquires shares shall have assets of not less than $25,000,000 at the date of purchase.

(c) The insurance company shall not acquire more than 5% of the outstanding shares of any one investment company.

(d) Investments in the shares of any one investment company shall not exceed 2% of the admitted assets of the insurance company as shown by the company's last annual report as filed with the state commissioner of insurance (determined on the basis of the cost of such shares to the insurance company at time of purchase).

Sec. 12. K.S.A. 1982 Supp. 40-2a09 is hereby amended as follows: 40-2a09. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in: (a) Stock in any insurance company, subsection (e) of K.S.A. 40-2a08 notwithstanding. Before more than 5% of the outstanding shares of stock of any insurance company is acquired, or a tender offer made therefor, prior written approval of the commissioner of insurance must be secured;

(b) stock in an incorporated insurance agency: (1) If 5% or less of the outstanding shares of stock of such agency is acquired, the provisions of K.S.A. 40-2a08 shall apply; (2) if more than 5% of the outstanding shares of such incorporated agency is acquired, or a tender offer is made therefor, the prior approval of the commissioner of insurance shall be required and the provisions of K.S.A. 40-2a08(d) shall apply . ~~and such stock~~ In valuing the stock of the agency, the assets of the agency shall be valued as if held directly by an insurance company; and (3) if majority interest in an incorporated insurance agency results from the organization of an agency by the insurance company to which this act applies, such investments shall be subject to the provisions of K.S.A. 40-2a16 until it has produced earnings for three out of five consecutive years. Such stock shall not be eligible for deposit with the commissioner of insurance as part of the legal reserve of such insurance company;

(c) stock in a holding corporation: (1) If 5% or less of the outstanding shares of stock of such holding corporation is acquired, the provisions of K.S.A. 40-2a08 shall apply;

(2) if at least 75% of the holding corporation's voting stock is acquired, the prior approval of the commissioner shall be required and the provisions of K.S.A. 40-2a08 shall not apply. No insurer may purchase in excess of 5% of the outstanding voting stock of a holding corporation unless such insurer acquires at least 75% of such stock. The commissioner may direct an insurer to divest of its ownership in a holding corporation acquired pursuant to this subsection if it appears to the commissioner that the continued ownership or operation of the holding corporation is not in the best interest of the policyholders, or if the insurer's ownership in the holding corporation is less than 75% of the outstanding voting stock of the holding corporation. A holding corporation acquired pursuant to this subsection shall not acquire any investment not permitted for insurance companies other than life pursuant to article 2a of chapter 40 of the Kansas Statutes Annotated. In valuing the stock of any holding corporation acquired under this subsection in the annual financial statement of the insurer, value shall be assigned to the holding corporation's assets as though the assets were owned directly by the insurer. A percentage of the holding corporation's assets exactly equal to the insurer's ownership interest in the holding corporation will be added to the assets of the insurer in application of the insurer's investment limitations set forth in article 2a of chapter 40 of the Kansas Statutes Annotated. Stock in a holding corporation acquired under this subsection shall not be eligible for deposit with the commissioner of insurance as part of the legal reserves of such insurer.

Sec. 13. K.S.A. 40-2a12 is hereby amended to read as follows: 40-2a12. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in:

(a) Bonds, notes, obligations or other evidences of indebtedness secured by mortgages or deeds of trust which are a first lien upon unencumbered real property and appurtenances thereto within the United States of America or any insular or territorial possession of the United States of America or any insular or territorial possession of the United States of America, or the Dominion of Canada, and upon lease-hold estates in real property wherein the term of such including any options to extend is not less than fifteen (15) years beyond the maturity of the loan as made or extended: ~~Provided, That~~ At the date of acquisition the total indebtedness secured by such lien shall not exceed ~~seventy-five percent (75%)~~ eighty percent (80%) of the market value of the property upon which it is a lien. These limitations shall not apply to obligations described in subsections (b), (c), (d) and (e) of this section: Provided further, That for

the purpose of this section a mortgage or deed of trust shall not be deemed to be other than a first lien upon property within the meaning of this section by reason of the existence of taxes or assessments against real property and appurtenances thereto that are not delinquent, instruments creating or reserving mineral, oil or timber rights, rights-of-way, joint driveways, sewer rights, rights in walls or by reason of building restrictions or other like restrictive covenants, or when such real estate is subject to lease in whole or in part whereby rents or profits are reserved to the owner or when there is in existence a fixed obligation or lien against the property where an escrow account or indemnification bond is or has been established or obtained sufficient to cover the maximum liability created by such obligation or lien;

(b) bonds, notes or other evidences of indebtedness representing loans and advances of credit that have been issued, guaranteed or insured by the United States government or any agency or instrumentality thereof: ~~Provided, That~~ Any uninsured or nonguaranteed portion shall not exceed ~~seventy-five percent (75%)~~ eighty percent (80%) of the total amount;

(c) contracts of sale, purchase money mortgages or deeds of trust secured by property obtained through foreclosure, or in settlement or satisfaction of any indebtedness;

(d) bonds, notes, obligations or other evidences of indebtedness secured by mortgages or deeds of trust which are a first lien upon unencumbered personal and real property, including a leasehold of real estate, under lease, purchase contract, or lease purchase contract to any governmental body or instrumentality whose obligations qualify under K.S.A. 40-2a01, 40-2a02 or 40-2a03 or to a corporation whose obligations qualify under K.S.A. 40-2a05: ~~Provided,~~ If there is adequate rental, after making allowances of lessors' or sellers' obligations and liabilities, if any, under the terms of said lease or contract, to retire the loan as to payment of principal and interest and ~~Provided further, That the~~ such rentals are pledged or assigned to the lender;

(e) bonds, notes or other evidences of indebtedness representing loans and advances of credit that have been issued, guaranteed or insured, in accordance with the terms and provisions of an act of the federal parliament of the Dominion of Canada approved March 18, 1954, cited as the "national housing act, 1954," as heretofore and hereafter amended.

(f) First mortgage or deeds of trust upon improved real property to be occupied as a personal residence by an officer of the insurer, if said mortgage is at an interest rate that is reasonably competitive with that charged by the other lending institutions in the community. Mortgages or deeds of trust entered into pursuant to this subsection shall be subject to the conditions set forth in subsection (a) of this section relating to mortgages or deeds of trust generally.

Sec. 14. K.S.A. 40-2a13 is hereby amended to read as follows: 40-2a13. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in real estate only if acquired or used for the following purposes and in the following manner:

(a) Such as shall be requisite for its convenient present and reasonable future accommodations in the transaction of its business. In the erection or purchase of any buildings for such purpose, additional space may be included for home office rental income; or

(b) such as shall have been mortgaged to it in good faith, by way of security for loans previously contracted or for money due; or

(c) such as shall have been conveyed to it in satisfaction of debts previously contracted in their legitimate business, or for money due; or

(d) such as shall have been purchased at sales upon judgments, decrees or mortgages obtained or made for such debts.

(e) such as shall have been acquired for development or income purposes.

It shall not be lawful for any such company to purchase, hold or convey real estate in any other case or for any other purpose; and all such real estate as may be acquired as aforesaid, and which shall not be necessary for the accommodation of such company in the transaction of its business, excepting real estate acquired for development or income purposes, shall be sold and disposed of within five (5) years after such company shall have acquired title thereto, unless the company shall procure a certificate from the commissioner of insurance that the interest of the company will suffer materially by a forced sale thereof, in which event the sale may be postponed for such period as the commissioner of insurance shall direct in said certificate. If the company so elects, real estate other than farm properties, which has been acquired

under subsections (c) and (d) of this section may be held by it for income purposes. ~~Provided, That its value together with that of all other real estate owned by said company at the time of such election does~~ The company's aggregate investment in real estate as herein provided shall not exceed ~~ten percent (10%)~~ twenty percent (20% of the admitted assets of said company as shown by its last annual report as filed with the state commissioner of insurance.

~~Any fire or casualty insurance company incorporated under the laws of this state owning real estate which has been acquired as a result of mortgage loans thereon by said company, whether by reason of foreclosure proceedings or by direct transfer from the mortgagor or which owns a certificate of purchase issued in any foreclosure proceedings on real estate in Kansas, may carry such real estate, or certificate, as part of its legal reserve: Provided, That the title to any building used as the home office and/or general office of a company shall not be deposited as part of the legal reserve.~~

~~Such real estate shall first be appraised, at the expense of such company, by three (3) disinterested resident freeholders of the county where the land is situated, authorized by the commissioner of insurance to make such appraisement, which appraisement shall be final, and the value of such real estate for the purpose of such reserves shall be the amount when by such appraisal, not exceeding the amount of unpaid balance of the face amount of the mortgage loan from which such real estate was acquired. Provided, however, That at no time shall the total amount of such real estate and/or certificate of purchase exceed fifty percent (50%) of the total amount of the gross reserve on all outstanding policies of the company, and reserves not to exceed ten percent (10%) of such gross reserve may be on real estate and/or certificates of purchase on real estate outside of Kansas. The commissioner of insurance shall have the right to reject at any time and return any property upon which taxes are delinquent, or fire insurance premiums unpaid. Deeds to such real estate and assignments of such certificates shall be executed by such company, conveying or assigning the title thereto to the then commissioner of insurance of the state of Kansas and his successors in office, in trust for the use and benefit of such company, and such deeds and such assignment shall be recorded in the office of the register of deeds of the county in which such real estate is situated.~~

~~Whenever the redemption period on any certificate signed to the commissioner shall have expired the sheriff of the county in which such land is situated shall issue a deed to said property to the commissioner of insurance and his successors in office in trust for the use and benefit of such company, and such deed shall be recorded and held in lieu of said certificate. When any company desires to withdraw such real estate from its reserves, the then commissioner of insurance shall, upon request, execute deeds to such person or persons, company or corporation, as such insurance company shall direct. Said appraisers shall each be allowed not to exceed the sum of twenty-five dollars ($25) per day in full for all services rendered except that the commissioner of insurance may appraise real estate outside of Kansas at the expense of the company in such manner as he may determine, and may reappraise all real estate once in every five (5) years.~~

Section 15. K.S.A. 40-2a16 is hereby amended as follows: 40-2a16. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest with the direction or approval of a majority of its board of directors or authorized committee thereof, any of its funds, or any part thereof in investments whether or not qualified and permitted under this act and notwithstanding any conditions or limitations prescribed therein, except that investments shall not be permitted in insolvent organizations or organizations in default with respect to the payment of principal or interest, and subject to the provisions of K.S.A. 17-3004, in an aggregate amount not more than ~~five percent (5%)~~ ten percent (10%) of its admitted assets as shown by the company's last annual report as filed with the commissioner of insurance.

New Sec. 16. Any insurance company other than life heretofore or hereafter organized under any law of this state may invest by loans or otherwise, with the direction or approval of a majority of its board of directors or authorized committee thereof, and of its funds, or any part thereof in the purchase of fixed wing aircraft, electric or mechanical machines constituting a word processing system, motor vehicles, and personal property used as a substitute for or in lieu of improvements upon real property such as detached modular systems, and thereafter may hold such assets as admitted assets for use in connection with the business of the company if, (1) the assets or asset system shall have a cost of not less than two thousand five hundred

dollars ($2,500) and such assets aggregate shall not, irrespective of K.S.A. 40-2a16 exceed five percent (5%) of the admitted assets of the company; (2) the cost of each asset or system shall be fully amortized over a reasonable period not to exceed ten (10) years. If an asset consists of separate but inter-dependent components each component shall be amortized over a reasonable period not to exceed ten (10) years commencing with the date of acquisition of each component. Personal property investments are not deemed eligible for deposit and shall not be included in the admitted assets for purposes of complying with minimum capital, surplus, or capital and surplus requirements applicable to issuance or continuation of a certificate of authority.

Sec. 17. K.S.A. 40-2b06, 40-2b07, 40-2b09, 40-2b10, 40-2b13, 40-2b20, 40-2a08, 40-2a09, 40-2a12, 40-2a13 and 40-2a16 are hereby repealed.

Sec. 18. This act shall take effect and be in force from and after its publication in the statute book.

EXPLANATORY MEMORANDUM FOR
LEGISLATIVE PROPOSAL NO. 8

Legislative Proposal No. 8 is a model act of the National Association of Insurance Commissioners. The NAIC model act and consequently the Kansas proposal is designed to address a serious problem that has arisen as a result of a federal preemption of state insurance regulation contained in the Employee Retirement Income Security Act of 1974 (ERISA). In essence, this federal act provides that no state law shall apply to employee welfare plans that qualify under the provisions of the ERISA act. Unfortunately, this opened the door for opportunists, particularly with respect to health insurance, whereby entrepreneurs would put together a plan; pay no attention to state laws because they would claim to be exempt under ERISA; proceed to sell health insurance to unsuspecting groups of persons; and, too many times it has been discovered that no one is around or no money is available when the time arrives for payment of claims.

This proposal represents one of a series of steps that are being taken at both the state and federal levels to gain control of a bad situation. This proposal would give the commissioner authority to determine whether a particular firm or plan was qualified under ERISA or subject to jurisdiction of another state or state agency. If not, the firm or plan would be subject to the laws of Kansas.

The Senate Commercial and Financial Institutions Committee will be requested to introduce this proposal.

Atch. I 6

LEGISLATIVE PROPOSAL NO. 8

AN ACT relating to insurance; health care benefits; jurisdiction; evidence required; disclosure.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF KANSAS:

Section 1. Notwithstanding any other provision of law, and except as provided herein, any person or other entity which provides coverage in this state for medical, surgical, chiropractic, physical therapy, speech pathology, audiology, professional mental health, dental, hospital, or optometric expenses, whether such coverage is by direct payment, reimbursement, or otherwise, shall be presumed to be subject to the jurisdiction of the commissioner of insurance unless the person or other entity conclusively shows that while providing such services it is subject to the jurisdiction of another agency of this or another state, any subdivisions thereof, or the federal government.

Sec. 2. A person or entity may show that it is subject to the jurisdiction of another agency of this or another state, any subdivision thereof, or the federal government by providing to the commissioner the appropriate certificate, license or other document issued by the other governmental agency which permits or qualifies it to provide those services.

Sec. 3. Any person or entity unable to show under section 2 of this act that it is subject to the jurisdiction of another agency of this or another state, any subdivision thereof, or the federal government shall submit to an examination by the insurance commissioner to determine the organization and solvency of the person or the entity, and to determine whether or not such person or entity complies with the applicable provisions of this code.

Sec. 4. Any person or entity unable to show that it is subject to the jurisdiction of another agency of this or another state, any subdivision thereof, or the federal government, shall be subject to all appropriate provisions of this code regarding the conduct of its business.

Sec. 5. Any production agency or administrator which advertises, sells, transacts, or administers coverage in this state described in section 1 of this act which is provided by any person or entity described in section 3 of this act shall, if that coverage is not fully insured or otherwise fully covered by an admitted insurer or other entity licensed to transact an insurance business in this state advise any purchaser, prospective purchaser, and covered person of such lack of insurance or other coverage.

Any administrator which advertises or administers coverage in this state, described in section 1 of this act which is provided by any person or entity described in section 3 of this act shall advise any production agency of the elements of the coverage including the amount of "stop-loss" insurance in effect.

Sec. 6. This act shall take effect and be in force from and after its publication in the statute book.

EXPLANATORY MEMORANDUM FOR
LEGISLATIVE PROPOSAL NO. 9

Legislative Proposal No. 9 will, if enacted, provide persons from circumventing the effects of having their agents licenses suspended or revoked by entering into some type of contractual or employment arrangement. Current Kansas law provides that agents licensing laws do not apply to traveling representatives. In the past, some contractual or employment arrangement has been made in order that persons whose license has been suspended or revoked can qualify as a salaried traveling representative. As a result, there have been instances where persons have had their agents license suspended or revoked and they have continued to transact business. Legislative Proposal No. 9 is intended to prevent this kind of activity.

The Senate Commercial and Financial Institutions Committee will be requested to introduce this proposal.

Att. I-c

LEGISLATIVE PROPOSAL NO. 9

AN ACT relating to insurance; agents' or brokers' licenses; revocation or suspension; amending K.S.A. 40-242 and repealing the existing section.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF KANSAS:

Section 1. K.S.A. 40-242 is hereby amended to read as follows: K.S.A. 40-242. (a) The commissioner of insurance may revoke or suspend the license of any broker or agent in the event that investigation by the commissioner discloses the fact that such license was obtained by fraud or misrepresentations or that the holder of such license had misrepresented the provisions, terms and conditions contained in any contract of insurance or that the holder of such license has rebated the whole or any part of any insurance premium or offered in connection with the presentation of a contract of insurance any other inducement not contained in the contract of insurance, or that the holder of such license has intentionally omitted any material fact in such presentation, or that the holder of such license has made any misleading representations or incomplete comparisons of policies to any person for the purposes of inducing or tending to induce such persons to lapse, forfeit or surrender his insurance then in force, or in the event that the interests of the insurer or the insurable interests of the public are not properly served under said license.

(b) The commissioner of insurance, before revoking or suspending any license, shall give to the broker or agent, and the company or companies represented by him or her, reasonable notice of a hearing to be held by the commissioner of insurance, at which hearing such broker or agent and the company or companies represented by him or her shall be given full opportunity to present such evidence as they deem pertinent to the issue involved. The commissioner, upon such hearing, may administer oaths, examine and cross-examine witnesses, receive oral and documentary evidence, and shall have the power to subpoena witnesses, compel their attendance, and require the production of books, papers, records, correspondence, or other documents relevant to the inquiry and in case of a refusal of any person to comply with any subpoena issued hereunder or to testify with respect to any matter concerning which he may be lawfully interrogated, the district court of Shawnee county or the county where such party resides, on the application of the commissioner, may issue an order requiring such person to comply with such subpoena and to testify; and any failure to obey any such order of the court may be punished by the court as a contempt thereof. Service of a subpoena upon a person named therein shall be made by delivering a copy thereof to such person and by tendering to such person the fees for one day's attendance and the mileage provided by law. The commissioner shall present the proper voucher for such sums as shall be required to make the service of subpoenas as herein provided and the proper official shall thereupon issue warrants in the amounts necessary. Statements of charges, notices, orders, and other processes of the commissioner, under this act may be served by anyone duly authorized by the commissioner, either in the manner provided by law for service of process in civil actions, or by registering and mailing a copy thereof to the person affected by such statement, notice, order, or other process at his or its residence or principal office or place of business. The verified return by the person so serving such statement, notice, order, or other process, setting forth the manner of such service, shall be proof of the same, and the return postcard receipt for such statement, notice, order or other process, registered and mailed as aforesaid, shall be proof of the service of the same.

(c) Nothing contained in this act shall require the observance at any such hearing of formal rules of pleading or evidence.

(d) The lapse or suspension of any license by operation of law, by failure to renew or by its voluntary surrender shall not deprive the commissioner of jurisdiction or right to institute or proceed with any disciplinary proceeding against such licensee, to render a decision suspending or revoking such license, or to establish and make a record of the facts of any violation of law for any lawful purpose. No such disciplinary proceedings shall be instituted against any licensee after the expiration of two (2) years from the termination of such license.

(e) No person whose license as an agent or broker has been suspended or revoked shall be employed by any insurance company doing business in this state either directly, indirectly, as an independent contractor or otherwise to negotiate or effect contracts of insurance, suretyship or indemnity or do any act toward soliciting or otherwise transacting the business of insurance during the period of such suspension or revocation.

Sec. 2. K.S.A. 40-252 is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

EXPLANATORY MEMORANDUM FOR
LEGISLATIVE PROPOSAL NO. 10

Legislative Proposal No. 10 is an amendment to the laws governing insurance holding companies. The amendment specifically would remove the provisions which provide that the commissioner may disapprove a merger or other acquisition under the holding company act if approval thereof would adversely affect the interest of securityholders. This is an amendment adopted by the National Association of Insurance Commissioners which the Kansas law is patterned after and arises from constitutional questions which have been raised in various jurisdictions including the United States Supreme Court.

The Senate Commercial and Financial Institutions Committee will be requested to introduce this proposal.

Att. I

LEGISLATIVE PROPOSAL NO. 10

AN ACT relating to insurance; amending K.S.A. 40-3304 and repealing the existing section.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF KANSAS:

Section 1. K.S.A. 40-3304 is hereby amended to read as follows: 40-3304. (a) No person other than the issuer shall make a tender offer for or a request or invitation for tenders of, or enter into any agreement to exchange securities for, seek to acquire, or acquire, in the open market or otherwise, any voting security of a domestic insurer if, after the consummation thereof, such person would, directly or indirectly (or by conversion or by exercise of any right to acquire) be in control of such insurer, and no person shall enter into an agreement to merge with or otherwise to acquire control of a domestic insurer unless, at the time any such offer, request, or invitation is made or any such agreement is entered into, or prior to the acquisition of such securities if no offer or agreement is involved, such person has filed with the commissioner of insurance and has sent to such insurer, and such insurer has sent to its shareholders, a statement containing the information required by this section and such offer, request, invitation, agreement or acquisition has been approved by the commissioner of insurance in the manner hereinafter prescribed. The requirements of this section shall not apply to the merger or consolidation of those companies subject to the requirements of K.S.A. 40-507 and 40-1216 to 40-1225, inclusive.

(1) For the purposes of this section a domestic insurer shall include any other person controlling a domestic insurer unless such other person is either directly or through its affiliates primarily engaged in business other than the business of insurance.

(b) The statement to be filed with the commissioner of insurance hereunder shall be made under oath or affirmation and shall contain the following information:

(1) The name and address of each person by whom or on whose behalf the merger or other acquisition of control referred to in subsection (a) of this section is to be affected (hereinafter called "acquiring party"), and (A) if such person is an individual, such individual's principal occupation and all offices and positions held during the past five (5) years, and any conviction of crimes other than minor traffic violations during the past ten (10) years; (B) if such person is not an individual, a report of the nature of its business operations during the past five (5) years or for such lesser period as such person and any predecessors thereof shall have been in existence; an informative description of the business intended to be done by such person and such person's subsidiaries; and a list of all individuals who are or who have been selected to become directors or executive officers of such person, or who perform or will perform functions appropriate to such positions. Such list shall include for each such individual the information required by paragraph (A) of this subsection.

(2) The source, nature and amount of the consideration used or to be used in effecting the merger or other acquisition of control, a description of any transaction wherein funds were or are to be obtained for any such purpose, and the identity of persons furnishing such consideration, except that where a source of such consideration is a loan made in the lender's ordinary course of business, the identity of the lender shall remain confidential, if the person filing such statement so requests.

(3) Fully audited financial information as to the earnings and financial condition of each acquiring party for the preceding five (5) fiscal years of each such acquiring party (or for such lesser period as such acquiring party and any predecessors thereof shall have been in existence), and similar unaudited information as of a date not earlier than ninety (90) days prior to the filing of the statement.

(4) Any plans or proposals which each acquiring party may have to liquidate such insurer, to sell its assets or merge or consolidate it with any person, or to make any other material change in its business or corporate structure or management.

(5) The number of shares of any security referred to in subsection (a) of this section which each acquiring party proposes to acquire, and the terms of the offer, request, invitation, agreement, or acquisition referred to in subsection (a) of this section, and a statement as to the method by which the fairness of the proposal was arrived at.

(6) The amount of each class of any security referred to in subsection (a) of this section which is beneficially owned or concerning which there is a right to acquire beneficial ownership by each acquiring party.

(7) A full description of any contracts, arrangements or understandings with respect to any security referred to in subsection (a) of this section in which any acquiring party is involved, including but not limited to transfer of any of the

securities, joint ventures, loan or option arrangements, puts or calls, guarantees of loans, guarantees against loss or guarantees of profits, division of losses or profits, or the giving or withholding of proxies. Such description shall identify the persons with whom such contracts, arrangements or understandings have been entered into.

(8) A description of the purchase of any security referred to in subsection (a) of this section during the twelve (12) calendar months preceding the filing of the statement, by any acquiring party, including the dates of purchase, names of the purchasers, and consideration paid or agreed to be paid therefor.

(9) A description of any recommendations to purchase any security referred to in subsection (a) of this section made during the twelve (12) calendar months preceding the filing of the statement, by any acquiring party, or by anyone based upon interviews or at the suggestion of such acquiring party.

(10) Copies of all tender offers for, requests or invitations for tenders of, exchange offers for, and agreements to acquire or exchange any securities referred to in subsection (a) of this section, and (if distributed) of additional soliciting material relating thereto.

(11) The terms of any agreement, contract or understanding made with any broker-dealer as to solicitation of securities referred to in subsection (a) of this section for tender, and the amount of any fees, commissions or other compensation to be paid to broker-dealers with regard thereto.

(12) Such additional information as the commissioner of insurance may by rule or regulation prescribe as necessary or appropriate for the protection of policyholders and securityholders of the insurer or in the public interest.

If the person required to file the statement referred to in subsection (a) of this section is a partnership, limited partnership, syndicate or other group, the commissioner of insurance may require that the information called for by paragraphs (1) through (12) of subsection (b) of this section shall be given with respect to each partner of such partnership or limited partnership, each member of such syndicate or group, and each person who controls such partner or member. If any such partner, member or person is a corporation or the person required to file the statement referred to in subsection (a) of this section is a corporation, the commissioner of insurance may require that the information called for by paragraphs (1) through (12) of subsection (b) of this section shall be given with respect to such corporation, each officer and director of such corporation, and each person who is directly or indirectly the beneficial owner of more than ten percent (10%) of the outstanding voting securities of such corporation.

If any material change occurs in the facts set forth in the statement filed with the commissioner of insurance and sent to such insurer pursuant to this section, and amendment setting forth such change, together with copies of all documents and other material relevant to such change, shall be filed with the commissioner of insurance and sent to such insurer within two (2) business days after the person learns of such change. Such insurer shall send such amendment to its shareholders.

(c) If any offer, request, invitation, agreement or acquisition referred to in subsection (a) of this section is proposed to be made by means of a registration statement under the securities act of 1933 or in circumstances requiring the disclosure of similar information under the securities exchange act of 1934, or under a state law requiring similar registration or disclosure, the person required to file the statement referred to in subsection (a) of this section may utilize such documents in furnishing the information called for by that statement.

(d) (1) The commissioner of insurance shall approve any merger or other acquisition of control referred to in subsection (a) of this section unless, after a public hearing thereon, said commissioner finds that:

(A) after the change of control the domestic insurer referred to in subsection (a) of this section would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed;

(B) the effect of the merger or other acquisition of control would be substantially to lessen competition in insurance in this state or tend to create a monopoly therein;

(C) the financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders ~~or the interests of any remaining securityholders who are unaffiliated with such acquiring party~~;

~~(D) the terms of the offer, request, invitation, agreement or acquisition referred to in subsection (a) of this section are unfair and unreasonable to the securityholders of the insurer;~~

~~(E)~~ (D) the plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest; or

~~(F)~~ (E) the competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control.

(2) The public hearing referred to in paragraph (1) of subsection (d) of this section shall be held as soon as practical after the statement required by this subsection (a) of this section is filed, and at least twenty (20) days' notice thereof shall be given by the commissioner of insurance to the person filing the statement. Not less than seven (7) days' notice of such public hearing shall be given by the person filing the statement to the insurer and to such other persons as may be designated by the commissioner of insurance. The insurer shall give such notice to its securityholders. The commissioner of insurance shall issue an order after the conclusion of such hearing setting forth said commissioner's findings. At such hearing, the person filing the statement, the insurer, any person to whom notice of hearing was sent, and any other person whose interests may be affected thereby shall have the right to present evidence, examine and cross-examine witnesses, and offer oral and written arguments.

(e) All statements, amendments, or other material filed pursuant to subsection (a) or (b) of this section, and all notices of public hearings held pursuant to subsection (d) of this section, shall be mailed by the insurer to its shareholders within five (5) business days after the insurer has received such statements, amendments, other material, or notices. The expenses of mailing shall be borne by the person making the filing. As security for the payment of such expenses, such person shall file with the commissioner of insurance an acceptable bond or other deposit in an amount to be determined by the commissioner of insurance.

(f) The provisions of this section shall not apply to:

(1) any offers, requests, invitations, agreements or acquisitions by the person referred to in subsection (a) of this section of any voting security referred to in subsection (a) of this section which, immediately prior to the consummation of such offer, request, invitation, agreement or acquisition, was not issued and outstanding;

(2) any offer, request, invitation, agreement or acquisition which the commissioner of insurance by order shall exempt therefrom as (A) not having been made or entered into for the purpose and not having the effect of changing or influencing the control of a domestic insurer, or (B) as otherwise not comprehended within the purposes of this section.

(g) The following shall be violations of this section:

(1) the failure to file any statement, amendment or other material required to be filed pursuant to subsection (a) or (b) of this section; or

(2) the effectuation or any attempt to effectuate an acquisition of control of, or merger with, a domestic insurer unless the commissioner of insurance has given his or her approval thereto.

(h) The courts of this state are hereby vested with jurisdiction over every security holder of a domestic insurer and every person not resident, domiciled, or authorized to do business in this state who files a statement with the commissioner of insurance under this section, and over all actions involving such person arising out of violations of this section, and each person shall be deemed to have performed acts equivalent to and constituting an appointment by such a person of the commissioner of insurance to be such person's true and lawful attorney upon whom may be served all lawful process in any action, suit or proceeding arising out of violations of this section. Copies of all such lawful process shall be served on the commissioner of insurance and transmitted by registered or certified mail by the commissioner of insurance to such person at such person's last known address.

Sec. 2. K.S.A. 40-3304 is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

EXPLANATORY MEMORANDUM FOR
LEGISLATIVE PROPOSAL NO. 11

This legislative proposal is principally designed to address an administrative problem. Currently, the laws governing agents licensing provide that the fee charged for taking an examination an agents license is not refundable. Conversely, no such provision is contained in the law regarding the fee for the insurance company certification that is required before an agent can transact business. Although it is not required, many applicants send the certification fee with their fee for the examination. When this occurs and the applicant then fails the examination, considerable time and expense is involved in producing the voucher, obtaining the warrant, recording the transaction and performing all the other details involved in returning the certification fee. Enactment of this proposal would alleviate this problem yet applicants can also avoid the risk by simply delaying submission of the certification fee until they are qualified for a license.

The provision added regarding insurance on growing crops is merely a technical change designed to assure that Kansas agents will not be denied the opportunity to sell federal crop insurance because of a unique provision in Kansas laws.

Finally, new section 2 would permit the commissioner to establish fees for services performed for the individual benefit of the requesting agent or company. Such fees would be established by regulation so all of the safeguards against the establishment of unreasonable or unnecessary fees would be present.

The Senate Commercial and Financial Institutions Committee will be requested to introduce this proposal.

Att. 2-e

LEGISLATIVE PROPOSAL NO. 11

AN ACT relating to insurance; agents licensing; fees to be established; authority to adopt regulations; agents certification fees to be retained; equivalent of certification; amending K.S.A. 40-241i and repealing the existing section.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF KANSAS:

Section 1. K.S.A. 40-241i is hereby amended to read as follows: 40-241i. Any company authorized to transact business in this state may, upon determining that the agent is of good business reputation and has had experience in insurance or will immediately receive a course of instruction in insurance and on the policies and policy forms of such company, certify such agent as the agent of the company under the license in effect for the agent. The certification shall be made to the commissioner on a form prescribed by him or her immediately upon appointment of the agent, shall be accompanied by the certification fees set forth in K.S.A. 40-252 and shall remain in effect until the first day of May unless the commissioner is notified to the contrary or the license of the certified agent is terminated. The certification fees shall not be returned for any reason.

With respect to insurance on growing crops, evidence satisfactory to the commissioner that the agent is qualified to transact insurance in accordance with standards or procedures established by any branch of the federal government shall be deemed to be the equivalent of certification by a company.

New Sec. 2. Except as otherwise specifically provided for herein, the commissioner may adopt regulations establishing reasonable fees necessary to accommodate the cost of issuing duplicate agents licenses, certifications of individual agent qualifications or credentials to other supervisory authorities, and similar functions performed by the commissioner for the benefit of insurance agents or companies or both.

Sec. 3. K.S.A. 40-241i is hereby repealed.

Sec. 4. This act shall take effect and be in force from and after its publication in the statute book.

KANSAS SAVINGS & LOAN LEAGUE

JAMES R. TURNER
PRESIDENT

SUITE 612 • 700 KANSAS AVE. • TOPEKA, KANSAS 66603 • PHONE (913) 232-8215

January 27, 1983

TO: SENATE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

FROM: JIM TURNER, KANSAS SAVINGS AND LOAN LEAGUE

RE: S.B. 50 (AML REGULATORY RESTRICTIONS - REPEALER)

The Kansas Savings and Loan League appreciates the opportunity to appear before the Senate Commercial and Financial Institutions Committee in support of S.B. 50 which would repeal state regulatory restraints upon adjustable mortgages. A copy of K.S.A. 1982 Supp. 16-207d is attached as a part of this testimony.

Title VIII of the Garn-St. Germain Depository Institutions Act of 1982 repeals state regulation of certain adjustable mortgage loans. Section 803 of the Act defines such loans as, "(s)ecured by an interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential manufactured home....." The loans are ones in which the interest rate may be adjusted or renegotiated or where the debt matures at intervals shorter than the amortization schedule. State chartered savings associations are permitted to use the Federal Home Loan Bank Board's regulations to make such loans.

The Kansas regulations (K.A.R. 104-1-1) cover adjustable rate notes secured by a real estate mortgage. As written they now apply only to non-residential real estate loans offered by state chartered savings and loans. Those loans could be regulated by the savings commissioner pursuant to K.S.A. 17-5501(s) which allows associations to make loans on the security of a first lien on real estate subject to such "(P)rohibitions, limitations and conditions as the commissioner may by regulation prescribe....." Loans made under the Uniform Consumer Credit Code are subject to regulation by the consumer credit commissioner under K.S.A. 16a-6-104.

Attachment II

To eliminate confusion in this area and the inequities between types of lending institutions, we are suggesting the K.S.A. 1982 Supp. 16-207d be repealed. For the committee's review, we have enclosed present and proposed federal regulations governing adjustable mortgages as well as a chart of the impact of the present Kansas statute. We would appreciate the committee's earliest consideration of reporting S.B. 50 favorably for passage.

James R. Turner
President

JRT:bw

Encl.

mortgages and contracts for deed to real estate executed on or after the effective date of this act shall be at an amount equal to 1 ½ percentage points above the average weighted yield of mortgages accepted under the federal home loan mortgage corporation's weekly purchase program effective on the first day of each month unless otherwise specifically authorized by law. Such interest rate shall be computed for each calendar month and be effective on the first day thereof. The secretary of state shall publish notice of such maximum interest rate in the first issue of the Kansas register published each month. The initial rate of interest upon any conventional loan evidenced by a note secured by a real estate mortgage shall not exceed the rate quoted in the application executed by the borrower on the day on which application for such conventional loan is made.

(c) No penalty shall be assessed against any party for prepayment of any home loan evidenced by a note secured by a real estate mortgage where such prepayment is made more than six months after execution of such note.

(d) The lender may collect from the borrower: (1) The actual fees paid a public official or agency of the state, or federal government, for filing, recording or releasing any instrument relating to a loan subject to the provisions of this section; and

(2) reasonable expenses incurred by the lender in connection with the making, closing, disbursing, extending, readjusting or renewing of loans subject to the provisions of this section.

(e) Any person so contracting for a greater rate of interest than that authorized by this section shall forfeit all interest so contracted for in excess of the amount authorized under this section; and in addition thereto shall forfeit a sum of money, to be deducted from the amount due for principal and lawful interest, equal to the amount of interest contracted for in excess of the amount authorized by this section and such amounts may be set up as a defense or counterclaim in any action to enforce the collection of such obligation and the borrower shall also recover a reasonable attorney's fee.

(f) The interest rates prescribed in subsections (a) and (b) of this section shall not apply to a business or agricultural loan. For the purpose of this section unless a loan is made primarily for personal, family or household purposes, the loan shall be considered a business or agricultural loan. For the purpose of this subsection, a business or agricultural loan shall include credit sales and notes secured by contracts for deed to real estate.

(g) Loans made by a qualified plan, as defined in section 401 of the internal revenue code, to an individual participant in such plan or to a member of the family of such individual participant, are not subject to the interest rates prescribed in subsections (a) and (b) of this section.

(h) The interest rates prescribed in subsections (a) and (b) of this section shall not apply to a note secured by a real estate mortgage or a contract for deed to real estate where the note or contract for deed permits adjustment of the interest rate, the term of the loan or the amortization schedule.

History: L. 1969, ch. 112, § 36; L. 1973, ch. 85, § 132; L. 1975, ch. 125, § 1; L. 1978, ch. 72, § 1; L. 1980, ch. 75, § 1; L. 1980, ch. 76, § 2; L. 1981, ch. 88, § 1; L. 1982, ch. 89, § 1; April 15.

Revisor's Note:

Section was amended twice in 1982 session. For other amendment see 16-207e.

Cross References to Related Sections:

Joint rules and regulations governing loans under subsection (h), see 16-207d.

Law Review and Bar Journal References:

"Combining Flexibility with Tax Sheltered Savings: Qualified Retirement Plan Loans," Alson R. Martin, 29 K.L.R. 179, 189 (1981).

"Alternate Methods of Financing the Sale and Purchase of Single Family Residences: Representing the Buyer and the Seller," Peter M. DiGiovanni, 50 J.K.B.A. 179, 185, 186 (1981).

"Interest and Usury in Kansas," Thomas V. Murray, 50 J.K.B.A. 270 (1981).

CASE ANNOTATIONS

1. Applied; subsection (d) requires the imposition of penalty when rate of interest usurious. Schulte v. Franklin, 6 K.A.2d 651, 653, 654, 633 P.2d 1151 (1981).

16-207d. Rules and regulations; adjustable loans. The state bank commissioner, consumer credit commissioner, savings and loan commissioner and credit union administrator shall jointly adopt rules and regulations for the purpose of governing loans made under the provisions of subsection (h) of K.S.A. 16-207, and any amend-

ments thereto, and subsection (8) of K.S.A. 16a-2-401, and any amendments thereto. Such rules and regulations shall be published in only one place in the Kansas administrative regulations as directed by the state rules and regulations board.

History: L. 1982, ch. 94, § 2; July 1.

16-207e. Contract rate; method of determination, limitations, penalties for prepayment of certain loans, recording fees; contracting for interest in excess of limitation, penalties, attorney fees; excluding pension plan loans and business and agricultural loans. [See Revisor's Note] (a) Subject to the following provision, the parties to any bond, bill, promissory note or other instrument of writing for the payment or forbearance of money may stipulate therein for interest receivable upon the amount of such bond, bill, note or other instrument of writing, at a rate not to exceed 10% per annum unless otherwise specifically authorized by law.

(b) The maximum rate of interest per annum for notes secured by all real estate mortgages and contracts for deed to real estate executed on or after the effective date of this act shall be at an amount equal to 1 ½ percentage points above the average weighted yield of mortgages accepted under the federal home loan mortgage corporation's weekly purchase program effective on the first day of each month unless otherwise specifically authorized by law. Such interest rate shall be computed for each calendar month and be effective on the first day thereof. The secretary of state shall publish notice of such maximum interest rate not later than the second issue of the Kansas register published each month. In the event the note secured by a real estate mortgage permits adjustments of the interest rate, the maximum rate of interest at the time of adjustment shall be the maximum rate of interest in effect at the time of each adjustment. The initial rate of interest upon any conventional loan evidenced by a note secured by a real estate mortgage shall not exceed the rate quoted in the application executed by the borrower on the day on which application for such conventional loan is made.

No penalty shall be assessed against any party for prepayment of any home loan evidenced by a note secured by a real estate mortgage made subject to the provisions of this subsection where such prepayment is made more than six months after execution of such note.

(c) The lender may collect from the borrower: (1) The actual fees paid a public official or agency of the state, or federal government, for filing, recording or releasing any instrument relating to a loan subject to the provisions of this section; and

(2) reasonable expenses incurred by the lender in connection with the making, closing, disbursing, extending, readjusting or renewing of loans subject to the provisions of this section.

(d) Any person so contracting for a greater rate of interest than that authorized by this section shall forfeit all interest so contracted for in excess of the amount authorized under this section; and in addition thereto shall forfeit a sum of money, to be deducted from the amount due for principal and lawful interest, equal to the amount of interest contracted for in excess of the amount authorized by this section and such amounts may be set up as a defense or counterclaim in any action to enforce the collection of such obligation and the borrower shall also recover a reasonable attorney's fee.

(e) The interest rates prescribed in subsections (a) and (b) of this section shall not apply to a business or agricultural loan. For the purpose of this section unless a loan is made primarily for personal, family or household purposes, the loan shall be considered a business or agricultural loan. For the purpose of this subsection, a business or agricultural loan shall include credit sales and notes secured by contracts for deed to real estate.

(f) Loans made by a qualified plan, as defined in section 401 of the internal revenue code, to an individual participant in such plan or to a member of the family of such individual participant, are not subject to the interest rates prescribed in subsections (a) and (b) of this section.

History: L. 1969, ch. 112, § 36; L. 1973, ch. 85, § 132; L. 1975, ch. 125, § 1; L. 1978, ch. 72, § 1; L. 1980, ch. 75, § 1; L. 1980, ch. 76, § 2; L. 1981, ch. 88, § 1; L. 1982, ch. 346, § 1; July 1.

Revisor's Note:

This section is second of two amendments to 16-207 in 1982 session. For first amendment see 16-207.

State of Kansas

CONSUMER CREDIT COMMISSIONER
STATE DEPARTMENT OF CREDIT UNIONS
SAVINGS AND LOAN DEPARTMENT
STATE BANK COMMISSIONER

NOTICE OF PUBLIC HEARING ON JOINT PROPOSED ADMINISTRATIVE REGULATIONS

You are hereby notified that a public hearing will be held at 10:30 a.m. on August 11, 1982, in Room 313-S, Capitol Building, Topeka, Kansas on temporary and permanent regulation 104-1-1. All interested parties may present oral comments at the hearing. Written comments may be sent to any of the following state agencies:

Consumer Credit Commissioner 535 Kansas Avenue, Suite 1114 Topeka, Kansas 66603	Department of Credit Unions 535 Kansas Avenue, Suite 1008 Topeka, Kansas 66603
Bank Commissioner 818 Kansas Avenue Topeka, Kansas 66612	Savings and Loan Department 503 Kansas Avenue, Room 220 Topeka, Kansas 66603

The regulation to be adopted is as follows:

104-1-1. Adjustable rate notes secured by a real estate mortgage or a contract for deed to real estate. For the purpose of adjusting the interest rate, the lender may use any interest-rate index that is readily verifiable by the borrower and is beyond the control of the lender. Adjustments to the interest rate of an adjustable mortgage loan shall correspond directly to the movement of the index, subject to any rate-adjustment limitations that a lender may provide. The initial index value shall be the most recently available value of the index at, or within six months prior to, the closing date of the loan. The amount of a rate adjustment shall reflect the difference between the initial index value and either: (a) the index value most recently available as of the date of rate adjustment, if the payment is not simultaneously adjusted, or (b) the index value most recently available as of the date of notification of a payment adjustment. When the movement of the index permits an interest-rate increase, the lender may decline to increase the interest rate by the indicated amount. The lender may decrease the interest rate at any time.

Adjustments to the interest rate may be implemented through adjustments to the outstanding principal loan balance or the loan term, through changes in the payment amount, or both. Adjustments shall be subject to the following conditions: (a) the total loan term shall not exceed 40 years; (b) the adjustments shall reflect the movement of the index; (c) the initial payment amount shall be sufficient to fully amortize the loan at the beginning of the loan term; and (d) the payment amount shall be adjusted at least every five years to a level sufficient to amortize the loan at the then-existing interest rate and principal loan balance over the remaining term of the loan.

The borrower shall not be charged any costs or fees in connection with regularly-scheduled adjustments to the interest rate, the payment, the outstanding principal loan balance, or the loan term.

At least 30, but not more than 45 days, before adjustment of the payment, a lender shall send written notification to the borrower containing the following information:

(a) a statement that the payment on the loan with the lender, secured by a mortgage or deed of trust on property located at the named address, is scheduled to be adjusted on a particular date;

(b) the outstanding balance of the loan on the adjustment date, assuming timely payment of the remaining payments due by that date;

(c) the interest rate on the loan as of the adjustment date, the index value on which that rate is based, the period of time for which that interest rate will be in effect, the next payment adjustment date, and the rate adjustment dates, if any, between the upcoming payment adjustment date and the next payment adjustment date;

(d) the payment amount as of the payment adjustment date;

(e) the dates, if any, on which the rate was adjusted since the last payment adjustment, the rates on each such rate adjustment date, and the index values corresponding to each such date;

(f) the dates, if any, on which the outstanding principal loan balance was adjusted since the last payment adjustment, and the net change in the outstanding principal loan balance since the last payment adjustment;

(g) the fact that the borrower may pay off the entire loan or a part of it without penalty when the prepayment is made more than six months after execution of the note; and

(h) the title and telephone number of a lender employee who can answer questions about the notice.

An applicant shall be given, at the time of receipt of an application, or upon request, a disclosure notice in substantially the following form:

IMPORTANT INFORMATION ABOUT THE ADJUSTABLE MORTGAGE LOAN
PLEASE READ CAREFULLY

You have received an application form for an adjustable mortgage loan ("AML"). The AML may differ from other mortgages with which you are familiar.

GENERAL DESCRIPTION OF ADJUSTABLE MORTGAGE LOAN

The adjustable mortgage loan is a flexible loan instrument. Its interest rate may be adjusted by the lender from time to time. Such adjustments will result in increases or decreases in your payment amount, in the outstanding principal loan balance, in the loan term, or in all three (see discussion below relating to these types of adjustments). Regulations place no limit on the amount by which the interest rate may be adjusted at any one time or over the life of the loan, or on the frequency with which it may be adjusted. Adjustments to the interest rate must reflect the movement of a single, specified index (see discussion below). For this reason, if you desire to have certain rate-adjustment limitations placed in your loan agreement, you should negotiate that matter with the lender. You may also want to make inquiries concerning the loan terms offered by other lenders on AMLs to compare the terms and conditions.

Another flexible feature of the AML is that the regular payment amount may be increased or decreased by the lender from time to time to reflect changes in the interest rate. Again, regulations place no limitations on the amount by which the lender may adjust payments at any one time, or on the frequency of payment adjustments. If you wish to have particular provisions in your loan agreement regarding adjustments to the payment amount, you should negotiate those terms with the lender.

A third flexible feature of the AML is that the outstanding principal loan balance (the total amount you owe) may be increased or decreased from time to time when adjustments to the interest rate result in a payment amount that is too small to cover interest due on the loan, or a payment amount that is larger than necessary to pay off the loan over the remaining term of the loan.

The final flexible feature of the AML is that the loan term may be lengthened or shortened from time to time, corresponding to an increase or decrease in the interest rate. When the term is extended in connection with a rate increase, the payment amount does not have to be increased to the same extent as if the term had not been lengthened. In no case may the total term of the loan exceed 40 years.

The combination of these four basic features allows a lender to offer a variety of mortgage loans. For example, one type of loan could permit rate adjustments with corresponding changes in the payment amount. Alternatively, a loan could permit rate adjustments to occur more frequently than payment adjustments, limit the amount by which the payment could be adjusted, and/or provide for corresponding adjustments to the principal loan balance.

INDEX

Adjustments to the interest rate of an AML must correspond directly to the movement of an index, subject to any rate-adjustment limitations that may be contained in the loan contract. If the index has moved down, the lender must reduce the interest rate by at least the decrease in the index. If the index has moved up, the lender has the right to increase the interest rate by that amount. Although increasing the interest rate is optional for the lender, you should be aware that the lender has this right and that the lender may become contractually obligated to exercise it.

The following is important information about the index to be applied to your AML.

1. *Name and description of index to be used for applicant's loan:*
   (provide relevent information here)
2. *The initial index value (if known) or date of initial index value:*
   (provide relevant information here)
3. *A source or sources where the index may be readily obtained by the borrower:*
   (provide relevant information here)
4. *The high and low index rates during the previous calendar year:*
   (provide relevant information here)

KEY TERMS OF ADJUSTABLE MORTGAGE LOAN

Following is a summary of the basic terms on the type of AML to be offered to you. This summary is intended for reference purposes only. The following important information relating specifically to your loan will be contained in the loan agreement.

1. *The loan term:*
   (provide relevant information here)
2. *The frequency of rate changes:*
   (provide relevant information here)
3. *The frequency of payment changes:*
   (provide relevant information here)
4. *The maximum rate change, if any, at one time:*
   (provide relevant information here)
5. *The maximum rate change, if any, over the life of the loan:*
   (provide relevant information here)
6. *The maximum payment change, if any, at one time:*
   (provide relevant information here)
7. *The minimum increments, if any, of rate changes:*
   (provide relevant information here).
8. *The adjustments to the principal loan balance:*
   (provide relevant information here)

HOW YOUR ADJUSTABLE MORTGAGE LOAN WOULD WORK

INITIAL INTEREST RATE

The initial interest rate offered by (lender's name) on your AML will be established and disclosed to you on (commitment date) based on market conditions at the time.

A short description of each key term of the AML offered to you follows (headings identify the key terms).
(provide relevant information here)

NOTICE OF PAYMENT ADJUSTMENTS

(Lender's name) will send you notice of an adjustment to the payment amount at least 30 but not more than 45 days before it becomes effective. The following is a description of information contained in the notice, as required by K.A.R. _____:
(provide relevant information here)

PREPAYMENT PENALTY

You may prepay an AML in whole or part without penalty when the prepayment is made more than six months after execution of such note.

FEES

You will be charged fees by (lender's name) and by other persons in connection with the origination of your AML. The lender will give you an estimate of these fees after receiving your loan application. However, you will not be charged any costs or fees in connection with any regularly-scheduled adjustment to the interest rate, the payment, the outstanding principal loan balance, or the loan terms initiated by the lender.

purporting to address the subject of a Federal association's ability or right to make, sell, purchase, participate or otherwise deal in the mortgage loan instruments set forth in this Part, or directly or indirectly to restrict such ability or right.

(b) *Determination of loan-to-value ratios.*

(1) In determining compliance with maximum loan-to-value limitations in this Part, at the time of making a loan an association shall add together the unpaid amount of all recorded loans secured by prior mortgages, liens or other encumbrances on the security property that would take precedence over the association's loan, and shall not make such a loan unless the total amount of such loans (including the one to be made but excluding loans that will be paid off out of the proceeds of the new loan) does not exceed applicable maximum loan-to-value limitations prescribed in this Part, as indicated by documentation retained in the loan file.

(2) In valuing the real estate security, an association shall use the current appraised value of the security property, which may include any expected value of improvements to be financed. "Value" for a real estate loan means market value.

(c) *Purchase of loans from the Federal Savings and Loan Insurance Corporation.* An association may purchase from the Federal Savings and Loan Insurance Corporation any real-estate-related loan guaranteed by the Corporation under a guarantee contract made by the Corporation with the purchasing association.

§ 545.6-1 Insured and guaranteed residential real estate loans.

(a) Notwithstanding any other provision of this Part, loans that are insured or guaranteed by a public mortgage insurer may be made in amounts and with terms and conditions of repayment acceptable to the insuring or guaranteeing agency.

(b) A loan is insured or guaranteed by a public mortgage insurer if:

(1) It comes within the definitions of §§ 541.10 or 541.13 of this Subchapter, or within the provisions of Title X of the National Housing Act; or

(2) It is insured or guaranteed by an agency or instrumentality of a state (i) whose full faith and credit is pledged to support the insurance or guarantee, or (ii) whose insurance or guarantee program is approved by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

.1 See also [§ 555.3]; #R4, #T11-4, #T11-6, and #T11-13.

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§ 545.6-2 Other residential real estate loans.

(a) *Home loans.* (1) *Authorization.* A Federal association may make, sell, purchase, participate, or otherwise deal in loans on the security of homes or combinations of homes and business property and on farm residences and combinations of farm residences and commercial farm real estate, including nonamortized, partially-amortized, and line-of-credit loans, on which the interest rate, the payment, the loan balance or the term to maturity may vary as provided in this paragraph (a). Such loans shall be repayable in at least semiannual installments over a term not exceeding 40 years, with interest payable at least semiannually except as expressly authorized in this paragraph (a). An association making a home loan shall possess only such rights and powers as are expressly set forth, by incorporation or otherwise, in the loan documents and as are provided by operation of law.

(2) *Adjustments to rate, payment, balance or term; refinancing.* Subject to such limitations on adjustment as are set forth in the loan contract:

(i) Adjustments to the interest rate shall correspond directly to the movement of an interest-rate index or of an index that measures the rate of inflation or the rate of change in consumer disposable income, which index is readily available to and verifiable by the borrower and is beyond the control of the association: *Provided,* that an association may decrease the interest rate at any time;

(ii) Adjustments to the payment and the loan balance that do not reflect an interest-rate adjustment may be made if (*a*) the adjustments reflect a change in a

national or regional index that measures the rate of inflation or the rate of change in consumer disposable income, is readily available to and verifiable by the borrower, and is beyond the control of the association, or (*b*) 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 and set forth in the contract;

(iii) Any combination of indices or a moving average of index values may be used as an index, and an association may use more than one index during the term of a loan;

(iv) A loan contract may provide for the deferral and capitalization of a portion of interest, and may provide that a portion of the consideration to be received by the association in return for making the loan shall be interest in the form of a percentage of the amount by which the current market value of the property, during the loan term or at maturity, exceeds the original appraised value;

(v) At least 30 but not more than 120 days prior to an adjustment and at least 90 but not more than 120 days prior to the expected maturity of a non- or partially-amortized loan (including a loan with a "call" provision pursuant to subparagraph (2)(vi) of this paragraph (a)), an association shall provide the borrower with notice of the adjustment or of maturity. However, where the loan contract provides that changes in the interest rate shall occur more frequently than changes in the payment, the association need not notify the borrower of changes in the rate, nor of changes in the loan balance or term resulting from a rate change, until notice of a payment adjustment is given. (For purposes of notification, a payment adjustment is considered to occur as of the date of the interest-rate change immediately preceding the due date of the adjusted payment.) In addition, where the loan contract sets out a schedule of payment adjustments, notice need not be given of payment changes made pursuant to that schedule;

(vi) The loan term may be adjusted only to reflect a change in the interest rate, the payment or the loan balance. A loan contract may provide an association with the right to call the loan due and payable either after a specified number of years has elapsed following closing or upon the occurrence of a specified event external to the loan; and

(vii) If at maturity of a loan that provides for adjustments pursuant to this subparagraph (a)(2) the ratio of the loan balance to the current market value of the security property exceeds 95 percent, the association may offer to refinance the loan, subject to the requirements of subparagraphs (3)(i) and (3)(iii) of this paragraph (a) and other applicable provisions of this Part.

(3) *Loan-to-value ratio.* A home loan shall not at the time of origination exceed 90 percent of the value of the security property, except as provided in subparagraph (2)(vii) of this paragraph (a) and below. During the term of the loan, the loan-to-value ratio may increase above 90 percent if the increase results from a change authorized by subparagraph (2) of this paragraph (a). The Board will assume continued compliance with the loan-to-value-ratio limitations where the original ratio met the requirements of this subparagraph (3), but in no event may the loan balance exceed 125 percent of the original appraised value of the property during the term of the loan unless pursuant to subparagraph (2)(ii)(*a*) of this paragraph (a) or unless the loan contract provides that the payment shall be adjusted at least once each five years, beginning no later than the tenth year of the loan, to a level sufficient to amortize the loan at the then-existing interest rate and loan balance over the remaining term of the loan. The 125-percent limitation shall not apply to that portion of a loan balance that is interest received in the form of a percentage of the appreciation in value of the security property pursuant to subparagraph (2)(iv) of this paragraph (a). Notwithstanding the foregoing, the loan-to-value ratio at the time of origination may be up to 95 percent if:

(i) The loan contract requires that, in addition to full or partial amortization of the loan, the *pro rata* portion, based on the number of installments due

annually, of estimated annual taxes and assessments on the security property be paid in advance to the association with each installment payment;

(ii) The borrower, including a purchaser who assumes the loan, has executed a certificate stating that the borrower occupies, or in good faith intends to occupy, the property (or one dwelling on the property) as the borrower's principal residence; and

(iii) During the time that the unpaid balance of the loan exceed 90 percent of the value of the security property, determined at the time of origination, the part of such balance exceeding 80 percent of value is guaranteed or insured by a mortgage insurance company which the Federal Home Loan Mortgage Corporation has determined to be a "qualified private insurer": *Provided,* however, that any unpaid loan balance secured by a pledged savings account shall not be required to be guaranteed or insured under this provision.

(4) *Loans to facilitate trade-in or exchange.* Loans made to facilitate the trade-in or exchange of security property shall not exceed 90 percent of value and shall be repayable within 18 months.

(5) *Pledged-account loans.* Loans made on the combined security of real estate and savings accounts may be made in excess of the maximum loan-to-value ratios specified in this paragraph (a), with such excess secured by savings accounts: *Provided,* that loans that exceed 90 percent of the value of the combined security are subject to the following restrictions:

(i) The loan shall not exceed the appraised value of the real estate;

(ii) The savings account shall consist only of funds belonging to the borrower, members of his family, or his employer; and

(iii) The association shall fully disclose to the prospective borrower the differences (including interest, private-mortgage-insurance costs, and equity interest) between a loan secured by real estate and savings and a loan secured by real estate alone.

(6) *Loans on cooperatives.* Such loans may be made under this paragraph (a), subject to the following requirements:

(i) *Loans on the security of cooperative housing developments ("blanket" loans).* The association shall require that the cooperative housing development maintain reserves at least equal to those required for comparable developments insured by the Federal Housing Administration.

(ii) *Loans on individual cooperative units.* Such loans may be made on the security of (*a*) a security interest in stock, membership certificate, or other evidence of ownership issued to a stockholder or member by a cooperative housing organization; and (*b*) an assignment of the borrower's interest in the proprietary lease or occupancy agreement issued by such organization.

(7) *Disclosure.* Prior to accepting an application for a loan, an association must disclose to each loan applicant, in one or more documents other than the loan documents and in plain language, the terms of the type(s) of loan(s) offered to the applicant. The purpose of this disclosure requirement is to ensure full understanding of the operation of the loan for which the individual is applying. The disclosures do not alone constitute a commitment on the part of an association to make a loan to a loan applicant. The disclosure material provided to an applicant shall include at least such of the following information as is relevant to the type of loan being offered:

(i) A general explanation of the fact that (*a*) the association and the applicant become bound by the terms of the loan contract upon signing it, (*b*) even though subsequently either party may request modification of the contract, neither party is bound to agree to such a request, and (*c*) since normally the loan contract and mortgage (or deed of trust) establish the rights of the borrower, the borrower should become familiar with and understand the provisions of those documents;

(ii) The term to maturity;

(iii) The initial interest rate, if known, or the manner in which the initial interest rate will be established;

(iv) The amount of the initial payment, if known, and an explanation of how the association establishes an amortization schedule for the loan, including how the association determines both the amount

of each payment and what proportion of each payment is credited to interest.

(v) A full explanation of how the interest rate, the payment, the loan balance, or the term to maturity may be adjusted (including identification of the index(es) to be used and how index values may be obtained by the borrower), and how the adjustment of one item may affect the others;

(vi) What information will be contained in each notice of an adjustment and, in the case of a non- or partially-amortized loan (including a loan giving the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan), in the notice of maturity, and how far in advance of an adjustment or maturity each notice will be provided;

(vii) A description of all contractual contingencies under which the loan may become due or which may result in a forced sale of the home;

(viii) If the loan is a non- or partially-amortized loan, unless the association unconditionally obligates itself to refinance the loan, a statement that a large payment will be due at maturity of the loan and that the association is under no obligation to refinance the loan; if the loan gives the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan, a statement that a large payment may be due at such time and that the association is not obligated to refinance the loan;

(ix) A description of any prepayment penalty provided for by the loan contract;

(x) Whether the loan contract will provide for escrow payments, the purpose of requiring escrow payments, and how the amount of an escrow payment is established; and

(xi) An example of the interaction of all variable features of the loan over any period of time.

(8) *Transition period.* Until December 31, 1982, associations may, or may commit to, make, purchase, participate or otherwise deal in loans made pursuant to §§ 545.6–4, 545.6–4a and 545.6–4b of this Part, as those sections were constituted prior to August 16, 1982.

(b) *Multifamily dwelling loans.* Loans on the security of other dwelling units, combinations of dwelling units, including homes, and business property involving only minor or incidental business use, shall not exceed 90 percent of the value of the security property and shall be repayable within 30 years, with interest payable at least semi-annually: *Provided,* that loans which are not fully amortized shall be repayable with principal and interest payments sufficient to meet a 30-year amortization schedule, and nonamortized loans shall be repayable within five years.

(c) *Loans on unimproved real estate ("acquisition" loans).* Loans on the security of unimproved real estate as defined in § 541.29 of this Subchapter shall not exceed 66⅔ percent of the value of the security property, and shall be repayable in 3 years with interest payable at least semi-annually.

(d) *Development loans.* (1) Loans to finance development of land shall not exceed 75 percent of the value of the security property and shall be repayable within 5 years, with interest payable at least semi-annually. The loan documentation shall contain a preliminary development plan that is satisfactory to the association.

(2) Upon release of any portion of the security property from the lien securing the loan, the principal balance of the loan shall be reduced by an amount at least equal to that portion of the outstanding loan balance attributable to the value of the property to be released. "Value" for the purposes of the preceding sentence is the value fixed at the time the loan was made.

(3) An association may extend the time for payment for an additional period not in excess of 3 years, but no extension may be made unless (i) interest on the loan is current, (ii) the association's board has before it a current appraisal of the security property, and (iii) the outstanding principal balance of the loan is or has been reduced to an amount not over 75

tion of a give-away on the recipient's possessing, opening, or adding to a savings account, or maintaining a minimum balance therein; (2) except under paragraph (d), refer in any of its advertising to any give-away, other than printed material of an educational or informational nature or a coin bank, with a cost not exceeding $2.50; or (3) enter any agreement with, or accept funds for investment in a savings account from, any person engaging in such activities.

(c) *Reciprocal statutory provision.* The statutory provision referred to in paragraph (b) must authorize a specified state official to impose by regulation restrictions on domestic associations of the state equivalent to those imposed on Federal associations by paragraphs (b)(1) and (2) if while the restriction is in force, Federal associations doing business in the state are likewise restricted.

(d) *Exception.* Notwithstanding paragraph (b), a Federal association may advertise give-aways during a single period of 30 days ending not more than one year after it opens its first office.

§545.1-5 *Public deposits, depositaries, and fiscal agents.*

(a) *Definitions.* As used in this section —

(1) "Moneys" includes "monies" and has the meaning it has in applicable State law;

(2) "State law" includes actions by a governmental body which has a charter adopted under the constitution of the State with provisions respecting deposits of public money of that body;

(3) "Surety" means surety under real and/or personal suretyship, and includes guarantor; and

(4) Terms in paragraph (b) of this section have the meanings they have in applicable state law.

(b) *Authority to act as surety.* (1) A Federal association that is a deposit association may give bond or security for deposit in it of public moneys or investment in it by a governmental unit if required to do so by state law, either as an alternative condition or otherwise, regardless of the amount required. Any bond or security may be given and any substitution or increase thereof may be made under this section at any time.

(2) If state law requires as a condition of such deposit or investment that the association or its bond or security, or any combination thereof, be surety for or with respect to other deposits or instruments, whether of that depositor or investor or of any other(s), and whether in the association or in any other institution(s) having, when the investments or deposits were made, insurance by the Federal Savings and Loan Insurance Corporation, the same shall become, or if the state law is self-executing shall be, such surety.

(3) Subject to regulation of the U.S. Treasury Department, a Federal association may serve as a depository for Federal taxes, as a Treasury tax and loan depository, as a depository of public money and fiscal agent of the Government, or any other instrumentality thereof when designated for that purpose by such instrumentality and approved by the Board, and satisfy any requirement in connection therewith, including: (1) maintaining accounts described in §526.1(n), (o), (p) and (q) of this Chapter, (2) pledging collateral, and (3) performing the services outlined in 31 CFR 202.3(b) (1981), or any section that supersedes or amends section 202.3(b).

(c) *Additional suretyship.* An association may also be surety to the extent that (1) it could have been surety if section 5(b) of the Act had not been amended by section 101(e) of Public Law 93-495, and (2) the Board otherwise authorizes in writing or by regulation.

§545.1-6 *Funds transfer services.* A Federal association may transfer its customer's funds from any account (including a line of credit) of the customer at the association or at another financial intermediary to third parties or to other accounts of the customer on the customer's order or authorization by any mechanism or device conforming with applicable laws and established commercial practices. An association may assess fees for providing any service authorized by this section. An association also may use cashier's checks or any other mechanism or device to effectuate transfers of its own funds in connection with any activities authorized under its charter or Board regulations.

§545.2 *Issuance of stock.*

A Federal association with a stock charter may raise capital by issuance of stock as provided by its charter and applicable provisions of this Chapter.

§545.2-1 *Issuance of mutual capital certificates.*

A Federal mutual association may issue mutual capital certificates as its charter permits but subject to the requirements of §563.7-4 of this Chapter or as the Board may otherwise authorize in writing.

§545.3 *Issuance of net worth certificates.*

A Federal association may issue net worth certificates as its charter permits and in accordance with Part 572 of this Chapter or as the Board may otherwise authorize in writing.

§545.4 *Borrowing.*

A Federal association may borrow, issue notes, bonds, debentures, obligations or securities and give security as authorized by its charter or approved in writing by the Board but subject to the requirements of §§563.8 and 563.8-2 of this Chapter.

§545.4-1 *Borrowing from a state-chartered central reserve institution.*

A Federal association which has amended its charter under §544.2(d) may borrow from a state-chartered central reserve institution, including a state mortgage finance agency, if:

(a) the association's general reserves, surplus, and undivided profits aggregate over 5 percent of its withdrawable accounts;

(b) the reserve institution is located in the state where the association's home office is located;

(c) the amount borrowed does not exceed the amount a state-chartered savings and loan in that state could borrow from that institution;

(d) the association does not use the loan proceeds to make loans at an interest rate exceeding by one and three-quarters percent per year the interest rate paid for the borrowed funds; and

(e) the association maintains any documentation required by the state regarding use of the loan proceeds or other matters.

II. Investments

§545.5 *Election regarding classification of loans or investments.*

If a loan or other investment is authorized under more than one section in this Part, an association may designate under which section the loan or investment has been made.

A. Loans

§545.6 *Real estate loans.*

(a) *General* (1) *Authorization.* A Federal association may originate, invest in, sell, purchase, service, participate, or otherwise deal in (including brokerage or warehousing) real estate loans or interests therein, subject to the restrictions of this Part. A real estate loan is any loan made on the security of residential or nonresidential real estate where the association relies substantially upon that real estate as the primary security for the loan. A loan secured by a lien on real estate is (i) a loan secured by an interest in real estate in fee or in a leasehold or subleasehold extending or renewable automatically at the option of the holder or the

Federal association for 5 years after maturity of the loan, if, in the event of default, the real estate interest could be used to satisfy the obligation with the same priority as a mortgage or a deed of trust in the jurisdiction where the real estate is located, or (ii) a loan secured by assignment of such loans. An association may purchase from the Fedeal Savings and Loan Insurance Corporation any real-estate-related loan guaranteed by the Corporation under a guaranty contract made by the Corporation with the purchasing association.

(2) *Determination of loan-to-value ratios* (i) In determining compliance with maximum loan-to-value limitations in this Part, at the time of making a loan an association shall add together the unpaid amount of all recorded loans secured by prior mortgages, liens or other encumbrances on the security property that would have priority over the association's loan, and shall not make such a loan unless the total amount of such loans (including the one to be made but excluding loans that will be paid off out of the proceeds of the new loan) does not exceed applicable maximum loan-to-value limitations prescribed in this Part.

(ii) In valuing the real estate security, an association shall use the current appraised value of the security property, which may include any expected value of improvements to be financed. "Value" for a real estate loan means market value.

(b) *Residential real estate loans.* A Federal association may make loans on the security of residential real estate, subject to the following restrictions:

(1) *Home loans.* A home loan made on the security of homes (including condominiums and cooperatives), combinations of homes and business property, farm residences, and combinations of farm residences and commercial farm real estate, including non-amortized, partially-amortized and line-of-credit loans. The interest rate, the payment, the loan balance or the term to maturity may vary as provided in paragraph (b)(1)(i). Home loans shall have a term not to exceed 40 years, with interest payable at least semiannually, except as expressly authorized in this paragraph (b)(1).

(i) *Adjustments to rate, payment, balance or term; refinancing.* Subject to such limitations on adjustment as are set forth in the loan contract:

(*a*) Adjustments to the interest rate shall correspond directly to the movement of an interest-rate index or of an index that measures the rate of inflation or the rate of change in consumer disposable income, which index is readily available to and verifiable by the borrower and is beyond the control of the association: *Provided,* that an association may decrease the interest rate at any time and: *Provided further,* that an association may increase the interest rate pursuant to a formula or schedule that specifies the amount of the increase and the time at which it may be made, and which is set forth in the loan contract;

(*b*) 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 a national or regional index that measures the rate of inflation or the rate of change in consumer disposable income, is readily available to and verifiable by the borrower, and is beyond the control of the association, or (*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 and set forth in the contract;

(*c*) Any combination of indices or a moving average of index values may be used as an index, and an association may use more than one index during the term of a loan;

(*d*) A loan contract may provide for the deferral and capitalization of a portion of interest, or of all interest on loans to natural persons secured by borrower-occupied property and on which periodic advances are being made, and may provide that a portion of the consideration to be received by the association in return for making the loan shall be interest in the form of a percentage of the amount by which the current market value of the property, during the loan term or at maturity, exceeds the original appraised value or as provided in §555.19 of this subchapter;

(*e*) At least 30 but not more than 120 days prior to an adjustment and at least 90 but not more than 120 days prior to the expected maturity of a non- or partially- amortized loan (including a loan with a "call" provision pursuant to subparagraph (i)(*f*) of this paragraph (b)(1)), an association shall provide the borrower with notice of the adjustment or of maturity. However, where the loan contract provides that changes in the interest rate shall occur more frequently than changes in the payment, the association need not notify the borrower of changes in the rate, nor of changes in the loan balance or term resulting from a rate change, until notice of a payment adjustment is given. (For purposes of notification, a payment adjustment is considered to occur as of the date of the interest-rate change immediately preceding the due date of the adjusted payment.) In addition, where the loan contract sets out a schedule of payment adjustments, notice need not be given of payment changes made pursuant to that schedule;

(*f*) The loan term may be adjusted only to reflect a change in the interest rate, the payment or the loan balance. A loan contract may provide an association with the right to call the loan due and payable either after a specified number of years has elapsed following closing or upon the occurrence of a specified event external to the loan; and

(*g*) If at maturity of a loan that provides for adjustments pursuant to this subparagraph (b)(1)(i) the ratio of the loan balance to the current market of the security property exceeds 95 percent, the association may offer to refinance the loan, subject to the requirements of subparagraphs (ii)(*a*) and (ii)(*c*) of this paragraph (b)(1) and other applicable provisions of this Part.

(ii) *Loan-to-value ratio.* A home loan shall not at the time of origination exceed 90 percent of the value of the security property, except as provided in subparagraph (i)(g) of this paragraph (b)(1) and below. During the term of the loan, the loan-to-value ratio may increase above 90 percent if the increase results from a change authorized by subparagraph (i) of this paragraph (b)(1).

The Board will assume continued compliance with the loan-to-value ratio limitations where the original ratio met the requirements of this subparagraph (ii), but in no event may the loan balance exceed 125 percent of the original appraised value of the property during the term of the loan unless pursuant to subparagraph (i)(*b*)(*1*) of this paragraph (1) or unless the loan contract provides that the payment shall be adjusted at least once each five years, beginning no later than the tenth year of the loan, to a level sufficient to amortize the loan at the then-existing interest rate and loan balance over the remaining term of the loan. The 125-percent limitation shall not apply to that portion of a loan balance that is interest received in the form of a percentage of the appreciation in value of the security property pursuant to subparagraph (1)(*d*) of this paragraph (b)(1). Notwithstanding the foregoing, the loan-to-value ratio at the time of origination may be up to 95 percent if:

(*a*) The loan contract requires that, in addition to full or partial amortization of the loan, the *pro rata* portion, based on the number of installments due annually, of estimated annual taxes and assessments on the security property be paid in advance to the association with each installment payment;

(b) The borrower, including a purchaser who assumes the loan, has executed a certificate stating that the borrower occupies, or in good faith intends to occupy, the property (or one dwelling on the property) as the borrower's principal residence; and

(c) During the time that the unpaid balance of the loan exceeds 90 percent of the value of the security property, determined at the time of origination, the part of such balance exceeding 80 percent of value is guaranteed or insured by a mortgage insurance company which the Federal Home Loan Mortgage Corporation has determined to be a "qualified private insurer": *Provided, however*, that any unpaid loan balance secured by a pledged savings account shall not be required to be guaranteed or insured under this provision.

(iii) *Loans on cooperatives.* A loan made on the security of a cooperative under this subparagraph (b)(1) shall comply with the following requirements:

(a) *Loans on the security of cooperative housing developments ("blanket" loans).* The association shall require that the cooperative housing development maintain reserves at least equal to those required for comparable developments insured by the Federal Housing Administration.

(b) *Loans on individual cooperative units.* Such loans may be made on the security of (1) a security interest in stock, membership certificate, or other evidence of ownership issued to a stockholder or member by a cooperative housing organization; and (2) an assignment of the borrower's interest in the proprietary lease or occupancy agreement issued by such organization.

(iv) *Loans to facilitate trade-in or exchange.* Loans made to facilitate the trade-in or exchange of security property shall not exceed 90 percent of value and shall be repayable within 18 months.

(v) *Pledged-account loans.* Loans made on the combined security of real estate and savings accounts may be made in excess of the maximum loan-to-value ratios specified in this paragraph (b)(1) with such excess secured by savings accounts: *Provided*, that loans that exceed 90 percent of the value of the combined security are subject to the following restrictions:

(a) The loan shall not exceed the appraised value of the real estate;

(b) The savings account shall consist only of funds belonging to the borrower, members of his family, or his employer; and

(c) The association shall fully disclose to the prospective borrower the difference (including interest, private-mortgage-insurance costs, and equity interest) between a loan secured by real estate and savings accounts and a loan secured by real estate alone.

(vi) *Disclosure.* Prior to accepting an application for a home loan, an association must disclose to each loan applicant, in one or more documents other than the loan documents and in plain language, the terms of the type(s) of loan(s) offered to the applicant. The purpose of this disclosure requirement is to ensure full understanding of the operation of the loan for which the individual is applying. The disclosure do not alone constitute a commitment on the part of an association to make a loan to a loan applicant. The disclosures material provided to an applicant shall include at least such of the following information as is relevant to the type of loan being offered:

(a) A general explanation of the fact that (1) the association and the applicant become bound by the terms of the loan contract upon signing it, (2) even though subsequently either party may request modification of the contract, neither party is bound to agree to such a request, and (3) since normally the loan contract and mortgage (or deed of trust) establish the rights of the borrower, the borrower should become familiar with and understand the provisions of those documents;

(b) The term to maturity;

(c) The initial interest rate, if known, or the manner in which the initial interest rate will be established;

(d) The amount of the initial payment, if known, and an explanation of how the association establishes an amortization schedule for the loan, including how the association determines both the amount of each payment and what proportion of each payment is credited to interest;

(e) A full explanation of how the interest rate, the payment, the loan balance, or the term to maturity may be adjusted (including identification of the index(es) to be used and how index values may be obtained by the borrower), and how the adjustment of one item may affect the others;

(f) What information will be contained in each notice of an adjustment and, in the case of a non- or partially-amortized loan (including a loan giving the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan), on the notice of maturity, and how far in advance of an adjustment or maturity each notice will be provided;

(g) A description of all contractual contingencies under which the loan may become due or which may result in a forced sale of the home;

(h) If the loan is a non- or partially-amortized loan, unless the association unconditionally obligates itself to refinance the loan, a statement that a large payment will be due at maturity of the loan and that the association is under no obligation to refinance the loan; if the loan gives the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan, a statement that a large payment may be due at such time and that the association is not obligated to refinance the loan;

(i) A description of any prepayment penalty provided for by the loan contract;

(j) Whether the loan contract will provide for escrow payments, the purpose of requiring escrow payments, and how the amount of an escrow payment is established; and

(k) An example of the interaction of all variable features of the loan over any period of time.

(2) *Multi-family dwelling loans.* A multi-family dwelling loan is a loan made on the security of real estate that is not a home (but which may include homes) and that is used primarily for residential purposes, or combinations of such real estate and business property that involves only minor or incidental business use. A multi-family dwelling loan shall not exceed 90 percent of the value of the security property and shall be repayable within 30 years: *Provided*, that nonamortized loans shall be repayable within 5 years. Interest shall be payable at least semi-annually except to the extent that the loan contract provides for the deferral and capitalization of interest: *Provided*, that the ratio of the loan balance to the current appraised value of the security property may not at any time during the loan term exceed 90 percent as a result of the deferral and capitalization of interest. The loan contract may provide that a portion of the consideration for making the loan shall be in the form permitted by §555.19 of this subchapter.

(c) *Nonresidential real estate loans.* (1) A Federal association may make loans on the security of nonresidential real estate: *Provided*, that any such loan shall not

RE: S.B. 50 (Repeal of Alternative Mortgage Loan Regulations)

If 1983 S.B. 50 is enacted to repeal K.S.A. 1982 Supp. 16-207d the following regulations would apply to alternative mortgage lending by financial institutions:

1. National Banks - Would be permitted to make any adjustable real estate mortgage (First and junior liens) under regulations issued by the Comptroller of the Currency.

2. State Chartered Banks

   a. Residential Real Estate Loans (First and junior liens) would be made under regulations issued by the Comptroller of the Currency.

   b. Non-Residential Real Estate Loans (First and junior liens) may be regulated by the Bank Commissioner under general rule making authority contained in K.S.A. 9-1713. (See note below).

   c. Uniform Consumer Credit Code Real Estate Loans (Junior liens held by a lender who did not make the first lien mortgage) could be regulated by the Consumer Credit Commissioner under general rule making authority contained in K.S.A. 16a-6-104. Residential real estate loans would be subject to regulations of the Comptroller of the Currency.

3. National Credit Unions - Would be permitted to make any adjustable real estate loans (First and junior liens) under regulations issued by the National Credit Union Administration Board.

4. State Chartered Credit Unions

   a. Residential Real Estate Loans (First and junior liens) would be made under regulations issued by the National Credit Union Administration Board.

   b. Non-Residential Real Estate Loans (First and junior liens) would not be subject to regulation.

   c. Uniform Consumer Credit Code Real Estate Loans could be regulated by the Consumer Credit Commissioner under general rule making authority contained in K.S.A. 16a-6-104. Residential real estate loans would be subject to regulation of the National Credit Union Administration Board.

5. Finance Companies

   a. Residential Real Estate Loans (First and junior liens) would be made under regulations issued by the Federal Home Loan Bank Board.

b. Non-Residential Real Estate Loans (First and junior liens) would not be subject to regulation.

c. Uniform Consumer Credit Code Real Estate Loans could be regulated by the Consumer Credit Commissioner under rule making authority contained in K.S.A. 16a-6-104. Residential real estate loans would be subject to regulations of the Federal Home Loan Bank Board.

6. Federally Chartered Savings and Loan Associations - Would be permitted to make any adjustable real estate mortgage (First and junior liens) under regulations issued by the Federal Home Loan Bank Board.

7. State Chartered Savings and Loan Associations

a. Residential Real Estate Loans (First and junior liens) would be made under the regulations issued by the Federal Home Loan Bank Board.

b. Non-Residential Real Estate Loans (First and junior liens) could be regulated by the Savings and Loan Commissioner, under K.S.A. 17-5501 which permits the association to make loans, "subject to such prohibitions, limitations and conditions as the commissioner may by regulation prescribe."

c. Uniform Consumer Credit Real Estate Loans could be regulated by the Consumer Credit Commissioner under general rules making authority contained in K.S.A. 16a-6-104. Residential real estate loans would be subject to regulations of the Federal Home Loan Bank Board.

There are two caveats to the above information. Since Uniform Consumer Credit Code loans must be made primarily for personal, family or household purposes the majority of such loans would be secured by residential real estate. Second, there is considerable disagreement about the ability of the State Bank Commissioner to regulate adjustable mortgage loans under K.S.A. 9-1713.

Testimony of the

Kansas Credit Union League

on SB 50, AML Regulation Repealer

presented to the

Senate Commercial and Financial Institutions Committee

January 27, 1983

by Marvin C. Umholtz
Governmental Affairs Director

Mr. Chairman, Members of the Committee:

Thank you for the opportunity to appear before this Committee to provide comments on SB 50 and the issues it raises.

Key to our association's consideration of this topic is our established policy position, which reads:

> Credit unions support obtaining and maintaining state and federal laws and regulations which are conducive to full participation by credit unions in all fields of lending.

KCUL can only support alternative mortgage transaction laws and regulations which allow the greatest ability of each credit union to tailor a lending program to serve its members.

Attachment III

KCUL considers the passage of SB 50 as one legitimate approach that the legislature may take under the circumstances created by the passage of Title VIII of the Depository Institutions Act of 1982. We can support this option and certainly do not oppose it. If K.S.A. 1982 Supp. 16-207d is repealed the regulations promulgated by the National Credit Union Administration (NCUA) would be applicable for both state and federally chartered credit unions.

Alternatively, if the legislature takes no action on SB 50, the credit union situation would not appear to be damaged. Section 804 of the DIA appears to be permissive. It reads, "...housing creditors may make, purchase and enforce alternative mortgage transactions..." (AMT). It is our view that a state chartered credit union could choose to make an AMT under either Title VIII (NCUA regulations) or K.A.R. 104-1-1, the state regulation.

If the legislature chooses to retain K.S.A. 1982 Supp. 16-207d, we would support the clarifying change recommended by the Kansas Bankers Association (KBA) in HB 2071. The amendment clarifies that K.A.R. 104-1-1 applies only to loans made primarily for personal, family or household purposes, and not business or agricultural purpose loans. Additionally, we would encourage the Committee to strike the word "shall" on line 0024 of HB 2071 and insert inlieu thereof the word "may."

At this time, we would oppose any effort to override the use of the federal AMT regulations as is permitted by Section 805 of the DIA. Enough confusion still surrounds the interpretation of Title VIII to preclude hasty action in this area. We could only support an override of

the use of the federal regulations if the state regulators were statutorily directed to promulgate regulations no more restrictive than those provided by the respective federal regulators.

I have included the following attachments:

1. Title VIII of the Depository Institutions Act of 1982
2. Federal Register, Vol. 47, No. 233 12-3-82 reflecting the actions of the NCUA Board at its December 16, 1982 meeting.
3. NCUA Regulations 12 C.F.R. Sec. 701.21-6B and Sec. 701.21-2 (prior to the amendments made by the NCUA Board at its December meeting).

Under the NCUA regulations as amended in December, a credit union can make AMT's for:

- first and second mortgages for residential purposes, including manufactured housing (one to four family dwelling, residance of the borrower)
- 30 - 40 year maturities on first mortgages (includes refinancing)
- 15 year maturities on seconds
- no sales price restrictions
- provides for growth equity mortgages (GEM) (GEM is a mortgage that provides for accelerated repayment of the loan, either as a result of scheduled increases of payment of principal and interest or as a result of movements in an index)
- adjustable rate index must be by an index or an average of an index agreed upon in advance and must be beyond the control of the credit union and readily verifiable by the borrower.

Thank you for the opportunity to address the Committee. I stand ready to address questions at the direction of the Chairman.

GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

PL 97-320

SEPTEMBER 30 (legislative day, September 8), 1982.—Ordered to be printed

Mr. GARN, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 6267]

TITLE VIII—ALTERNATIVE MORTGAGE TRANSACTIONS

SHORT TITLE

SEC. 801. This title may be cited as the "Alternative Mortgage Transaction Parity Act of 1982".

FINDINGS AND PURPOSE

SEC. 802. (a) The Congress hereby finds that—

(1) increasingly volatile and dynamic changes in interest rates have seriously impared the ability of housing creditors to provide consumers with fixed-term, fixed-rate credit secured by interests in real property, cooperative housing, manufactured homes, and other dwellings;

(2) alternative mortgage transactions are essential to the provision of an adequate supply of credit secured by residential property necessary to meet the demand expected during the 1980's; and

(3) the Comptroller of the Currency, the National Credit Union Administration, and the Federal Home Loan Bank Board have recognized the importance of alternative mortgage transactions and have adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing.

(b) It is the purpose of this title to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.

DEFINITIONS

SEC. 803. As used in this title—

(1) the term "alternative mortgage transaction" means a loan or credit sale secured by an interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential manufactured home (as that term is defined in section 603(6) of the National Manufactured Home Construction and Safety Standards Act of 1974)—

(A) in which the interest rate finance charge may be adjusted or renegotiated;

(B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or

(C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation;

described and defined by applicable regulation; and

(2) the term "housing creditor" means—

(A) a depository institution, as defined in section 501(a)(2) of the Depository Institutions Deregulation and Monetary Control Act of 1980;

(B) a lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act;

(C) any person who regularly takes loans, credit sales, or advances secured by interests in properties referred to in paragraph (1); or

(D) any transferee of any of them.

A person is not a "housing creditor" with respect to a specific alternative mortgage transaction if, except for this title, in order to enter into that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law, and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law.

ALTERNATIVE MORTGAGE AUTHORITY

SEC. 804. (a) In order to prevent discrimination against State-chartered depository institutions, and other nonfederally chartered housing creditors, with respect to making, purchasing, and enforcing alternative mortgage transactions, housing creditors may make, purchase, and enforce alternative mortgage transactions, except that this section shall apply—

(1) with respect to banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Comptroller of the Currency for national banks, to the extent that such regulations are authorized by rulemaking authority granted to the Comptroller of the Curren-

ATTACH T 1.

cy with regard to national banks under laws other than this section;

(2) with respect to credit unions, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the National Credit Union Administration Board for Federal credit unions, to the extent that such regulations are authorized by rulemaking authority granted to the National Credit Union Administration with regard to Federal credit unions under laws other than this section; and

(3) with respect to all other housing creditors, including without limitation, savings and loan associations, mutual savings banks, and savings banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Federal Home Loan Bank Board for federally chartered savings and loan associations, to the extent that such regulations are authorized by rulemaking authority granted to the Federal Home Loan Bank Board with regard to federally chartered savings and loan associations under laws other than this section.

(b) For the purpose of determining the applicability of this section, an alternative mortgage transaction shall be deemed to be made in accordance with the applicable regulation notwithstanding the housing creditor's failure to comply with the regulation, if—

(1) the transaction is in substantial compliance with the regulation; and

(2) within sixty days of discovering any error, the housing creditor corrects such error, including making appropriate adjustments, if any, to the account.

(c) An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.

APPLICABILITY

SEC. 805. (a) The provisions of section 804 shall not apply to any alternative mortgage transaction in any State made on or after the effective date (if such effective date occurs on or after the effective date of this title and prior to a date three years after the effective date of this title) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the preemption provided in section 804 to apply with respect to alternative mortgage transactions subject to the laws of such State, except that section 804 shall continue to apply to—

(1) any alternative mortgage transaction undertaken on or after such date pursuant to an agreement to undertake such alternative mortgage transaction which was entered into on or after the effective date of this title and prior to such later date (the "preemption period"); and

(2) any renewal, extension, refinancing, or other modification of an alternative mortgage transaction that was entered into during the preemption period.

(b) An alternative mortgage transaction shall be deemed to have been undertaken during the preemption period to which this section applies if it—

(1) is funded or extended in whole or in part during the preemption period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period; or

(2) is a renewal, extension, refinancing, or other modification of an alternative mortgage transaction entered into before the preemption period and such renewal, extension, or other modification is made during such period with the written consent of any person obligated to repay such credit.

RELATION TO OTHER LAW

SEC. 806. Section 501(c)(1) of the Depository Institutions Deregulation and Monetary Control Act of 1980 shall not apply to transactions which are subject to this title.

EFFECTIVE DATE

SEC. 807. (a) This title shall be effective upon enactment.

(b) Within sixty days of the enactment of this title, the Comptroller of the Currency, the National Credit Union Administration, and the Federal Home Loan Bank Board shall identify, describe, and publish those portions or provisions of their respective regulations that are inappropriate for (and thus inapplicable to), or that need to be conformed for the use of, the nonfederally chartered housing creditors to which their respective regulations apply, including without limitation, making necessary changes in terminology to conform the regulatory and disclosure provisions to those more typically associated with various types of transactions including credit sales.

And the Senate agree to the same.

FERNAND J. ST GERMAIN,
HENRY S. REUSS,
FRANK ANNUNZIO,
J. W. STANTON,
CHALMERS P. WYLIE,
Managers on the Part of the House.

JAKE GARN,
JOHN TOWER,
DICK LUGAR,
DON RIEGLE,
ALAN CRANSTON,
Managers on the Part of the Senate.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 745

Conforming Amendments To Lending Regulations; Growth Equity Mortgages; Regulation of Due-on-Sale for Window Period Loans; Alternative Mortgage Transactions Study

AGENCY: National Credit Union Administration (NCUA)

ACTION: Final regulations.

SUMMARY: A number of provisions of the Garn-St Germain Depository Institutions Act of 1982 apply to loans made by credit unions and require action by NCUA. Title V amends the Federal Credit Union Act, revising the procedures for processing loan applications, removing certain restrictions on loans that Federal credit unions can grant, and confirming that Federal credit unions may make loans meeting secondary market requirements. It also requires NCUA to conform its lending regulations. Title III preempts state prohibitions on the enforcement of due-on-sale clauses. It requires NCUA to act to permit Federal credit unions to enforce due-on-sale clauses in certain loans made before October 15, 1982. Title VIII provides state credit unions parity with Federal credit unions in making alternative mortgage loans. It requires NCUA to study its regulations and identify those that will and those that will not apply to state credit unions In order to give state and Federal credit unions more flexibility to design their own loan programs as soon as possible, NCUA is simultaneously taking the necessary steps to implement the provisions of these Titles of the Garn-St Germain Act.

EFFECTIVE DATE: November 18, 1982.

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, Deputy General Counsel, or John L. Culhane, Jr., Senior Attorney, Department of Legal Services, National Credit Union Administration, 1776 G Street, N.W., Washington, D.C. 20456 or telephone (202) 357-1030.

SUPPLEMENTARY INFORMATION: A number of provisions of the Garn-St Germain Depository Institutions Act of 1982 apply to loans made by credit unions. To implement these provisions, NCUA is taking the following actions.

Conforming Amendments to Lending Regulations

Among other things, Title V of the Garn-St Germain Act amends the Federal Credit Union Act provisions that apply to loans made by Federal credit unions. It revises the procedures for processing loan applications, making a credit committee optional and requiring a loan to an official to be approved by the board of directors only where the official's total indebtedness exceeds $10,000 plus pledged shares, rather than $5,000 plus pledged shares, as had been the case. It expands the authority of Federal credit unions to make loans: allowing first mortgage loans to be made for more than 30 years, to be made regardless of the sales price, and to be refinanced; allowing second mortgage loans to be made for 15 years, regardless of the purpose; and allowing loans on terms acceptable to a government agency that has made an advance commitment to purchase the loans. It also confirms the ability of Federal credit unions to comply with secondary market requirements, permitting certain limits on the prepayment of mortgage loans and permitting the insurance of custodial accounts. These statutory changes require NCUA to conform its lending regulations.

As a result, NCUA is making the following changes to its regulations. References to the procedures for processing loan applications in §§ 701.21-1 and 701.21-4 are being revised to include the possibility that loans may be approved by the board of directors. In § 701.21-4, references to the trigger for board of directors approval of a loan to an official are being revised from $5,000 plus pledged shares to $10,000 plus pledged shares. NCUA's regulations on mortgage loans, §§ 701.21-6, 701.21-6A, and 701.21-6B, are being revised to allow first mortgage loans to be financed or refinanced for up to 40 years and to be made regardless of the sales price. These regulations are also being revised to permit certain limitations on the prepayment of mortgage loans. And a new § 745.3(d) is being added to provide for the insurance of custodial accounts. For convenience, certain technical changes are also being made at this time.

Growth Equity Mortgages

A growth equity mortgage is a mortgage that provides for the accelerated repayment of the loan, either as a result of movements in an index or as the result of scheduled increases in payments of principal and interest. Mindful of the emphasis that the Garn-St Germain Act places on equity loans made by Federal credit unions, as many of the amendments of Title V are designed to facilitate equity loans, and on alternative mortgage loans made by Federal and state credit unions, and as Title VIII is designed to facilitate alternative mortgage loans by providing state credit unions parity with Federal credit unions, the NCUA Board believes that it is appropriate at this time to authorize growth equity mortgages for Federal credit unions.

Section 701.21-6(b)(2) of NCUA's regulations requires that a fixed rate long term first mortgage loan be amortized by substantially equal monthly installments sufficient to retire the loan at maturity, although other amortization schedules may be approved with the prior written consent of the Administration. In promulgating this regulation, NCUA was exercising its plenary and exclusive authority set forth in sections 107(5)(A)(i) and 107(5)(A)(ix) of the Federal Credit Union Act to regulate the real estate loans granted by Federal credit unions and the amortization of loans granted by Federal credit unions. This exercise of the Board's authority preempted state laws purporting to address the ability of a Federal credit union to set its own loan amortization schedules, either directly or indirectly. Pursuant to that authority, and in accordance with its regulation, the NCUA Board hereby provides written consent for all Federal credit unions to make growth equity first mortgage loans with initial maturities in excess of 12 years.

Regulation of Due-on-Sale Clauses for Window Period Loans

A Federal credit union's ability to exercise a due-on-sale clause is now governed by section 341 of Title III of the Garn-St Germain Act. Under section 341, a Federal credit union may generally exercise a due-on-sale clause if the loan was made after October 15, 1982, or if the loan was made in a state that permitted the exercise of due-on-sale clauses; in states that prohibited the exercise of due-on-sale, a Federal credit union may not generally exercise a due-on-sale clause in the case of a transfer that took place before October 15, 1982.

Special rules apply, however, in the case of loans made during a "window" period, the length of which will vary from state to state. A state has a window period only if the state either passed a statute prohibiting the exercise of a due-on-sale clause or a state court handed down a decision, applicable state wide, prohibiting the exercise of a due-on-sale clause. In that case, the window period begins on the date of enactment, or date of decision, and ends October 15, 1982.

If a loan is made or assumed during the window period, then a Federal credit union cannot enforce a due-on-sale clause except in the case of transfers that take place on or after October 15, 1985. However, NCUA can adopt regulations to handle window period loans differently, either by shortening or lengthening the time the prohibition on the enforcement of due-on-sale clauses will apply. The time may not, however, be shortened to a date earlier than the date of adoption of the regulations.

NCUA is therefore republishing its regulations governing the exercise of due-on-sale clauses in long term first mortgage loans in order to enable Federal credit unions to exercise due-on-sale clauses in the case of transfers that take place on or before November 18, 1982. NCUA originally chose to require the use of an instrument containing a due-on-sale clause because of its belief that the ability of a Federal credit union to exercise the rights afforded by a due-on-sale clause was essential to a Federal credit union's safe and sound participation in the long term residential mortgage market. Because Federal credit unions assessed the risks of entering into this market in reliance upon NCUA's regulation, the NCUA Board believes that prompt action is necessary to protect the safety and soundness of those credit unions that chose to enter the long term residential mortgage market.

Alternative Mortgage Transactions Study

Title VIII of the Garn-St Germain Act provides state credit unions parity with Federal credit unions in making alternative mortgage loans. Section 807 of the Act requires NCUA to study its regulations to identify those regulations that will not apply to state credit unions.

For purposes of clarity, NCUA is making certain amendments to its regulations so that state credit unions may more easily locate those regulations under which Federal credit unions make alternative mortgage loans. Briefly, as amended, Federal credit unions make alternative mortgage loans under § 701.21-2 of NCUA's regulations (short term adjustable rate first mortgage loans, adjustable rate mobile home loans, adjustable rate second mortgage loans, et cetera), § 701.21-3 of NCUA's regulations (lines of credit), § 701.21-5 of NCUA's regulations (loans made pursuant to government insured or guaranteed loan programs or pursuant to an advance commitment by a government agency to purchase the loans), § 701.21-6 of NCUA's regulations (long term growth equity loans), and § 701.21-6B of NCUA's regulations (long term adjustable rate first mortgage loans).

A preliminary review of these regulations was conducted and various state credit union supervisors, trade associations and other interested parties were advised that it did not appear that any of the provisions of these regulations would be inappropriate for use by state credit unions. As none of these parties have objected to these conclusions, at this time the NCUA Board does not believe that there are any regulatory provisions that are inappropriate for use by state credit unions.

Procedures for Regulatory Development

The NCUA Board for good cause finds that notice and public comment on these regulations is unnecessary and contrary to the public interest. The conforming amendments to the lending regulations merely remove inconsistencies between the statutory and regulatory provisions governing lending by Federal credit unions. The due-on-sale regulations are necessary to preserve the safety and soundness of those Federal credit unions that entered into the long term residential mortgage market in reliance upon regulations promulgated after notice and public comment. The regulations adopted to facilitate alternative mortgage transactions by state credit unions merely clarify the authority currently afforded Federal credit unions. For the same reasons, and because the regulations remove restrictions, the final regulations are being made effective in less than 30 days.

The final regulations will not have a significant economic impact on a substantial number of small credit unions. The conforming amendments merely remove inconsistencies between the statutory and regulatory provisions governing lending and will therefore increase their flexibility. The due-on-sale regulations will not have a significant economic impact on a substantial number of small credit unions because only a few credit unions with less than $1 million in assets are making or have made long term residential mortgage loans. The regulations adopted to clarify the authority of Federal credit unions to make alternative mortgage loans will likewise not have a significant economic impact on a substantial number of small credit unions because only a few credit unions with less $1 million in assets will make alternative mortgage loans. Therefore, a Regulatory Flexibility Analysis is not required.

List of Subjects in 12 CFR Parts 701 and 745

Credit unions, Mortgages, Insurance.

By the National Credit Union Administration Board on the 18th of November 1982.

Rosemary Brady,

Secretary of the Board.

PART 701—[AMENDED]

Authority: 12 U.S.C. 1757, 1766(a), and 1789(a)(11).

Accordingly, 12 CFR Parts 701 and 745 are amended as set forth below.

1. 12 CFR 701.21-1(c) is revised to read as follows:

§ 701.21-1 Lending policies.

* * * * *

(c) Subject to limitations established by the board of directors, when a loan is approved the board of directors, the credit committee or the loan officer, whichever approved the loan, shall assure that a credit application is on file which supports the decision to extend credit.

2. 12 CFR 701.21-2(b) is revised to read as follows:

§ 701.21-2 Amortization and payment of loans to members.

* * * * *

(b) This rule is promulgated pursuant to the exclusive authority of the NCUA Board to regulate lending and loan amortization as set forth in sections 107(5), 107(5)(A)(ii) and 107(5)(A)(ix) of the Federal Credit Union Act, 12 U.S.C. 1757(5), (5)(A)(ii) and (5)(A)(ix). This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's ability or right to make adjustable rate consumer loans, short term adjustable rate first mortgage loans, short term growth equity mortgage loans, adjustable rate mobile home loans, adjustable rate second mortgage loans, and other similar loans or to directly or indirectly restrict such ability or right.

§ 701.21-4 [Amended]

3. 12 CFR 701.21-4(b) is amended by adding the words "As provided in the bylaws, the board of directors," before the words "the credit committee or loan officer shall act upon all applications."

4. 12 CFR 701.21-4(c)(3) is amended by removing the word "$5,000" and by inserting in its place the word "$10,000."

5. 12 CFR 701.21-5 is added to read as follows:

§ 701.21-5 Insured, guaranteed and advance commitment loans.

(a) A loan secured by the insurance or guarantee of, or with advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either may be made for the maturity and under the terms and conditions specified in the law under which such insurance, guarantee or commitment is provided.

6. 12 CFR 701.21-6 is revised to read as follows:

§ 701.21-6 Long term fixed rate first mortgage loans.

(a) For purposes of this section: (1) "One-to-four family dwelling" means a structure designed for residential use by not more than four families. The term includes a one-to-four family unit in a cooperative housing development. The term also includes a one-to-four family unit in a planned unit development or condominium project where certain portions of the security property are owned in common with others.

(2) "Principal residence" means a structure where the member will be domiciled or will reside permanently within 6 months after initial disbursement of the loan, or within 18 months provided the structure is being newly constructed or extensively rehabilitated.

(3) "Value" means the lower of the appraised market value or the purchase price. In the case of a residence being rehabilitated, "Value" shall also include the cost of rehabilitation. The cost of rehabilitation shall be supported by a good faith estimate.

(4) "Appraisal" means an objective estimate of value based upon a physical examination and evaluation which shall disclose the market value of the security offered by use of the market sales approach which shall be supported by an analysis of comparable properties in the immediate area. The market value should also be supported by use of the cost and income appraisal methods if conditions warrant.

(5) "Appraiser" means a person who is experienced in the appraisal of one-to-four family dwellings and is actively engaged in such appraisal work and whose qualifications are demonstrated by membership in a national professional appraisal organization, or who is licensed to appraise in the state in which the residence is located or who is acceptable as an appraiser by an insuring or guaranteeing agency of the Federal or State government.

(6) "Market value" means the highest price which the residence will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

(7) "Security instrument" means either a Deed of Trust, Mortgage or Leasehold Mortgage which constitutes a first lien, or in the case of a loan on a one-to-four family dwelling in a cooperative housing development, a Security Agreement which constitutes a first security interest in stock or a membership certificate issued to a tenant stockholder or resident member of a cooperative housing organization and which provides for the assignment of the borrower's interest in the proprietary lease or right of tenancy in property issued by such organization. Only in those areas of the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico where an interest in real estate is customarily evidenced by leasehold or ground estates will the term "Leasehold Mortgage" be included in this definition.

(8) "Escrow account" means either a special limited withdrawal share account or accounts payable account for the accumulation of funds to pay for not more than one year's taxes, assessments, insurance premiums, construction proceeds, or other charges that could affect the credit union's first lien or first security interest.

(9) "Title insurance" means insurance protecting the credit union against loss due to clouds or defects in title to the residence equaling the current principal balance of the loan and also protecting and benefiting subsequent purchasers of the loan.

(10) "Hazard insurance" means property insurance affording protection against loss or damage from fire and other hazards covered by the industry's standard extended coverage endorsement which provides for payment of an amount sufficient to pay the loan balance in the event of a covered loss, with a standard clause in favor of the credit union and subsequent purchasers of the loan.

(b) Within the limitations of written policies adopted by the board of directors, Federal credit unions may originate loans secured by first liens on residential real property or secured by first security interests in residential cooperatives, with maturities in excess of 12 years and not exceeding 40 years, provided: (1) Loans shall be made to finance or refinance a one-to-four family dwelling that is or will be the principal residence of the Federal credit union member.

(2) Loans shall be amortized by substantially equal monthly installments sufficient to retire the loan at maturity. Each monthly installment shall be applied first to taxes and insurance due and payable (when an escrow account is established), then to interest currently due and payable, with the remainder to prinicpal. Amortization shall commence no later than 61 days after disbursemen of proceeds and shall not exceed 40 years from date of disbursement. With prior written consent of the Administration, loans may be amortized by other than substantially equal monthly installments.

(3) The aggregate dollar amount of such loans outstanding may not exceed 25 per centum of the Federal credit union's assets without prior written consent of the Administration. This limitation does not include loans with maturities not exceeding 12 years.

(4) The loan shall not exceed 90 per centum of value at the time of disbursement except that the loan amount may equal up to 95 per centum of value provided that private mortgage insurance is obtained for the amount of the loan in excess of 90 per centum of value.

(5) The loan application shall be the current revision of FHLMC Form 65/ FNMA Form 1003 or its equivalent.

(6) The security instruments and notes shall be executed on the current revision of the FNMA/FHLMC Uniform Instruments for the jurisdiction in which the property is located or their equivalent. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal.

(7) The loan shall be secured by a perfected first lien or first security interest in favor of the credit union supported by a properly executed and recorded security instrument. No loan shall be secured by a residence located outside the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico.

(8) Where an interest in real estate is customarily evidenced by leasehold or ground rent estates, loans shall comply with the preceding provisions of this section in addition to the procedures customarily followed to perfect an interest in a leasehold or ground rent estate.

(9) A Federal credit union may require the member/borrower to maintain an escrow share account. If a member's loan is assumed by a nonmember, any required escrow account shall be maintained as interest bearing account payable. The rate of interest paid on such accounts shall be at least equal to the lowest yielding dividend rate paid on any share accounts offered by the credit union.

(10) Each loan file shall contain the following: (i) A loan application supported by an executed sales contract and any modifications bearing the signature of the applicant(s).

(ii) A written appraisal on the current revision of FHLMC Form 70/FNMA Form 1004; FHLMC 465; FNMA Form 1004–A or their equivalent, prepared and signed prior to approval of the loan application by an appraiser who shall provide a certification on the current revision of FHLMC Form 439 or its equivalent.

(iii) When applicable, a private insurance certificate.

(iv) A complete settlement statement (Form HUD–1) detailing all charges and fees and distribution of the loan proceeds.

(v) An opinion of title signed by an attorney licensed to practice in the jurisdiction in which the property is located or a title insurance policy affirming the quality and the position of the first lien or first security interest.

(vi) A current hazard insurance policy.

(vii) A flood insurance policy, if required.

(viii) A properly executed note and security instrument and a document indicating the date and place(s) of recording of such instruments.

(c) The following restrictions shall be applicable to all loans made under this section: (1) A Federal credit union shall not grant any loan on the prior condition, agreement, or understanding that the borrower contract with any specific person or organization for the following: (i) Insurance services (as an agent, broker, or underwriter);

(ii) Building materials or construction services;

(iii) Legal services rendered to the borrower; and

(iv) Services of a real estate agent or broker.

(2) Notwithstanding the preceding paragraph, a Federal credit union may refuse to grant any loan if it believes, on reasonable grounds, that the insurance services provided by the person or organization selected by the borrower will afford insufficient protection to the credit union.

(3) A Federal credit union shall not make any loan if, either directly or indirectly, any commission, fee or other compensation is to be paid to, or received by, any of its officials or employees in connection with the procuring or insuring of the loan.

(4) Early repayment of a loan involving points or finance charges shall require recomputation. A refund, or an adjustment of the final payment, must be made to ensure that the true rate of interest has not exceeded the maximum rate authorized by law at the time the loan was granted. This requirement also applies to loans the credit union has sold in whole or in part.

(d) Due-on-sale clauses: (1) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by section 341 of the Garn-St Germain Depository Institutions Act of 1982 and by any regulations issued by the Federal Home Loan Bank Board implementing section 341 of the Garn-St Germain Act.

(2)(i) In the case of a contract involving a loan made pursuant to this section which was made or assumed, including a transfer of the liened property subject to the loan, during the period beginning on the date a State adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies state-wide) prohibiting such exercise and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

(A) The creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;

(B) The creation of a purchase money security interest for household appliances;

(C) A transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(D) The granting of a leasehold interest of 3 years or less not containing an option to purchase;

(E) A transfer to a relative resulting from the death of a borrower;

(F) A transfer where the spouse or children of the borrower become an owner of the property;

(G) A transfer resulting from a decree of a dissolution of marriage, legal separation agreements, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(H) A transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(I) Any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.

(ii) This section is being promulgated pursuant to the plenary and exclusive authority of the NCUA Board as set forth in Sections 107(5)(A)(i), 107(5)(A)(ix), and 107(13) of the Federal Credit Union Act to regulate, respectively, the real estate loans granted by Federal credit unions, the amortization of loans granted by Federal credit unions, and the sale of loans granted by Federal credit unions. This exercise of the Board's authority preempts state laws purporting to address the ability of a Federal credit union to exercise its rights under a due on sale clause to raise interest rates on these loans.

7. 12 CFR 701.21–6A is amended by revising paragraphs (b)(1), (b)(2)(i), (b)(2)(iii), and (b)(3) to read as follows:

§ 701.21–6A Business relationship with mortgage lender.

* * * * *

(b) * * *

(1) *General Loan Terms.* A loan will only be granted to finance or refinance the acquisition of a one-to-four family dwelling that is or will be the principal residence of the borrower. The maturity will not exceed 40 years. The loan will be secured by a first lien or first security interest on the dwelling.

(2) * * *

(i) *Interest Rate.* The interest rate charged on the loan will not exceed the maximum rate permitted a Federal credit union at the time the loan is granted.

(ii) * * *

(iii) *Prepayment.* The borrower will be able to repay the loan prior to maturity

in whole or in part on any business day without penalty, although the mortgage lender may require that any partial prepayment be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments which would be applicable to principal.

(3) *Insured, Guaranteed or Advance Commitment Loans.* A loan secured by the insurance or guarantee of, or with advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either may be made under the additional terms and conditions specified in the law under which such insurance, guarantee or commitment is provided.

§ 701.21-6B [Amended]

8. 12 CFR 701.21-6B is amended by revising the title to read as follows:

§ 701.21-6B Long term adjustable rate first mortgage loans.

9. 12 CFR 701.21-6B(b)(1) is amended by removing the words "on residential real property" and inserting the words "or first security interests on the residence" and by removing the word "30" and by inserting in its place the word "40."

10. 12 CFR 701.21-6B(1)(ii) is amended by removing the words "Section 701.21-6(b)(4)" and by inserting in their place the words "Section 701.21-6(b)(3)."

11. 12 CFR 701.21-6B(1)(iii) is amended by removing the words "Section 701.21-6(b)(7)" and by inserting in their place the words "§ 701.21-6(b)(6)."

§ 701.21-7 [Amended]

12. 12 CFR 701.21-7(b)(3) is amended by removing the words "Part 701.21-6(b)(4) of this Chapter" and by inserting in their place the words "§ 701.21-6(b)(3)."

§ 701.21-8 [Amended]

13. 12 CFR 701.21-8(a)(3) is revised to read as follows:

(a) * * *

(3) "Real estate loan" means a loan granted on a one-to-four family dwelling that is or will be the principal residence of the borrower and which is secured by a first lien or first security interest on the dwelling.

* * * * *

14. 12 CFR 701.21-8(b)(iv) is amended by removing the words "section 701.21(6)(b)(4)" and by inserting in their place the words "§ 701.21-6(b)(3)."

PART 745—[AMENDED]

15. 12 CFR Part 745 is amended by adding a new § 745.3(d) to read as follows:

§ 745.3 Single ownership accounts.

* * * * *

(d) *Custodial Accounts.* Loan payments received by a Federal credit union prior to remittance to other parties to whom the loan was sold pursuant to section 107(13) of the Federal Credit Union Act and § 701.21-8 of NCUA's regulations shall be considered to be funds owned by the borrower and shall be added to any individual accounts of the borrower and insured up to $100,000 in the aggregate.

[FR Doc. 82-32337 Filed 12-2-82; 8:45 am]
BILLING CODE 7535-01-M

§701.21-6B Adjustable Rate Mortgage Loans

(a) Definition.

(1) An adjustable rate mortgage loan is a mortgage loan which permits the periodic adjustment of the rate of interest on the loan in response to the movement of an index which was agreed upon in advance by the borrower and the Federal credit union.

(b) Authorization.

(1) Federal credit unions are permitted to make adjustable rate mortgage loans to members. Such loans must be secured by first liens on residential real property and must have initial maturities in excess of 12 years and not exceeding 30 years. Loans which are made under the provisions of this rule shall also comply with all the provisions of Section 701.21-6 of the NCUA Rules and Regulations except for the following:

(i) The provisions of Section 701.21-6(b)(2) (which require substantially equal monthly payments);

(ii) The provisions of Section 701.21-6(b)(4) (which limit the aggregate dollar amount of fixed rate mortgage loans to 25 per centum of the credit union's assets); and

(iii) The provisions of 701.21-6(b)(7) (which require the use of the FNMA/FHLMC Uniform Instruments).

(2) This rule is promulgated pursuant to the plenary and exclusive authority of the NCUA Board as set forth in Sections 107(5)(A)(i), 107(5)(A)(ix), and 107(13) of the Federal Credit Union Act to regulate, respectively, the real estate loans granted by Federal credit unions, the amortization of loans granted by Federal credit unions, and the sale of loans granted by Federal credit unions. This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's ability or right to make adjustable rate mortgage loans or to directly or indirectly restrict such ability or right.

(c) Amortization.

(1) Adjustable rate mortgage loans shall be amortized by monthly installments sufficient to retire the loan at maturity. If the principal balance of the loan is adjusted in response to a movement in the index, the amount of the monthly payment shall be adjusted at least every 5 years to a level sufficient to amortize the loan balance at the then existing interest rate over the remaining term of the loan.

(d) Adjustment Options.

(1) Adjustments to the interest rate may be implemented through changes in the monthly payment amount, through adjustment to the outstanding principal loan balance, through extension of the loan maturity or by a combination of these adjustments.

(2) Adjustments shall not cause the maturity to exceed 40 years.

(3) Adjustments may be made as frequently as monthly.

(4) The maximum amount of any one adjustment may be capped.

(e) Index.

(1) The adjustment in the interest rate shall correspond with the movement of an index or an average of an index agreed upon in advance, subject to such rate adjustment limitations, if any, as a Federal credit union may provide. The index must be beyond the control of the Federal credit union and readily verifiable by the borrower.

(2) Where the index or an average of an index has moved downward, a decrease in the interest rate is mandatory except to the extent that:

(i) The decrease is offset by previously permitted interest rate increases not taken;

(ii) The decrease exceeds a cap limitation;

(iii) The decrease in the interest rate is less than one-eighth of 1 percent; or

(iv) The decrease would reduce the interest rate below a minimum rate agreed upon in advance by the borrower and the Federal credit union.

(f) Costs or Fees.

(1) The borrower shall not be charged any costs or fees in connection with regularly scheduled adjustments to the interest rate, the monthly payment, the outstanding principal loan balance, or the loan maturity.

§701.21-2 Amortization and Payment of Loans to Members

(a) General Rule: Loans shall be paid or amortized in accordance with written policies prescribed by the board of directors after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interests of the members and such other factors as the board deems relevant.

(b) This rule is promulgated pursuant to the exclusive authority of the NCUA Board to regulate consumer lending and loan amortization as set forth in sections 107(5), 107(5)(A)(ii), 107(5)(A)(iii) and 107(5)(A)(ix) of the Federal Credit Union Act. 12 U.S.C. 1757(5), (5)(A)(ii), (5)(A)(iii), and (5)(A)(ix). This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's ability or right to make variable rate consumer loans or to directly or indirectly restrict such ability or right.

Session of 1983

HOUSE BILL No. 2071

By Committee on Commercial and Financial Institutions

1-21

AN ACT relating to adjustable loans; concerning certain types thereof; amending K.S.A. 1982 Supp. 16-207d and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 1982 Supp. 16-207d is hereby amended to read as follows: 16-207d. The state bank commissioner, consumer credit commissioner, savings and loan commissioner and credit union administrator shall jointly adopt rules and regulations for the purpose of governing loans *made primarily for personal, family or household purposes and* made under the provisions of subsection (h) of K.S.A. 16-207, and any amendments thereto, and subsection (8) of K.S.A. 16a-2-401, and any amendments thereto. Such rules and regulations shall be published in only one place in the Kansas administrative regulations as directed by the state rules and regulations board.

Sec. 2. K.S.A. 1982 Supp. 16-207d is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

Attachment IV

SENATE COMMITTEE
ON
COMMERCIAL
AND
FINANCIAL INSTITUTIONS

PUBLIC TESTIMONY ON SB 50

BY
KANSAS BANKERS ASSOCIATION

JANUARY 27, 1983

Attachment V

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

January 27, 1983

TO: Senate Committee on Commercial and Financial Institutions

RE: SB 50

Mr. Chairman and Members of the Committee:

The KBA staff appreciates very much the opportunity to appear before you in favor of the passage of SB 50. This bill would repeal 16-207d which was Section 2 of SB 559 from the 1982 session. That section of the bill required the various state commissioners to establish rules and regulations relating to adjustable rate mortgages.

Subsequent to the promulgation of those state rules and regulations, the United States Congress passed the Garn-St. Germain Act which also speaks to the issue of regulation of adjustable rate mortgages. Title XIII of that Act states that the Comptroller of the Currency can issue regulations governing alternative or adjustable rate mortgage transactions for national banks and that those regulations can also be used by state-chartered banks if desired. Under clarifications issued on December 27, 1982 by the Office of the Comptroller of the Currency, it is stated that state-chartered banks are not "not required to comply with the Office's ARM regulation. State banks may continue to make ARM loans under the provisions of state law even if state law does not conform with 12 CFR Part 29." Therefore, we are now of the opinion that state banks do have an option of (1) making adjustable rate loans secured by liens on one to four family dwellings which comply with the guidelines set forth by the Kansas commissioners or (2) complying with the guidelines for the same type of loans as set forth by the Comptroller of the Currency.

Our more immediate concern relating to the Kansas act centers around the fact that the language in SB 559 is not totally clear as to whether these state adjustable rate mortgage regulations apply only to adjustable rate loans for residential housing (one to four family) or whether they also apply to adjustable rate commercial and agricultural loans. We sincerely believe that it was the legislative intent in 1982 to have regulations apply only to residential ARMs. We have requested the introduction of legislation in the House Committee on Commercial and Financial Institutions which would clarify this issue (HB 2071).

If SB 50 is passed, it would end some of the present confusion for state-chartered banks as which guidelines to follow and it would remove the question of whether the state regulations apply to adjustable rate commercial and agricultural loans. However, we cannot say at this time whether state-chartered banks would prefer to use the state or the OCC regulations in relation to adjustable rate residential loans.

Office of Executive Vice President • 707 Merchants National Building
Eighth and Jackson • Topeka, Kansas 66612 • (913) 232-3444

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 29

[Docket No. 82-24]

Adjustable-Rate Mortgages

AGENCY: Comptroller of the Currency, Treasury.

ACTION: Final rule

SUMMARY: State-chartered banks are permitted by Title VIII of the Garn-St Germain Depository Institutions Act of 1982 to make or purchase loans in accord with the Office of the Comptroller of the Currency's regulations relating to alternative mortgage transactions. The purpose of this notice is to identify those portions of the Office's regulations that are deemed inapplicable to state banks and, where necessary, to modify the regulations for use by state banks. This notice is required by that Act.

EFFECTIVE DATE: December 14, 1982.

FOR FURTHER INFORMATION CONTACT: David Nebhut, Financial Economist, Economic and Policy Analysis Division, 202-447-1825; or Jerome L. Edelstein, Attorney, or Francis S. Rath, Attorney, Legal Advisory Services Division, 202-447-1880.

SUPPLEMENTARY INFORMATION: Title VIII of the Garn-St Germain Depository Institutions Act of 1982, provides that state banks may make real estate loans with adjustable-rate features in accordance with this Office's regulations, relating to alternative mortgage transactions. The Act also requires that the Office identify, describe, and publish any portions of its regulations that are inappropriate for state banks. The Office has reviewed its Adjustable-Rate Mortgage Regulation, 12 CFR Part 29, and its other regulations relating to real estate lending, and identified the following provisions as inappropriate for state banks:

—The requirement in 12 CFR 29.5(d)(2)(1) that the original loan term not exceed 30 years. This requirement is imposed so that loans made or purchased by national banks in accordance with the regulation will comply with 12 U.S.C. 371(a) which requires that the term of a residential mortgage loan not exceed 30 years. State banks may be subject to different statutory limitations on the term of a loan. Such state statutory requirements will continue to control the maximum loan term;

—The authority provided by 12 CFR 29.9 enabling national banks to make certain types of mortgage loans, with the prior approval of the Office, that do not conform to the ARM regulation. Section 29.9 is inapplicable to state banks because it requires a case-by-case review of each loan program, and the loan programs are subject to termination or modification by the Office at any time. The Office does not have the examination and supervisory authority over state banks to administer such a review program;

—The transition period provided by 12 CFR 29.10. Section 29.10 is inapplicable to state banks because, under the Act, they are not required to comply with the Office's ARM regulation. State banks may continue to make ARM loans under the provisions of state law, even if state law does not conform with 12 CFR Part 29. Consequently, no transition period is necessary.

—The Appendix to Part 29 which refers only to national banks in the suggested forms. Any reference in these forms to the lender as a "national bank" should be replaced by a reference to the lender as a state bank.

The Office is also adding to its ARM regulation a provision specifying which provisions of the regulation will apply to state banks as well as national banks.

The Office is also clarifying that 12 CFR Part 29 applies to the making or purchasing of loans secured by liens on mobile homes, even when such loans are characterized as "credit sales". National and state banks should read the term "loan" as "credit sale" wherever appropriate.

In making this notice, the Office has identified regulations which it has issued, and modified portions of its ARM regulations which are inapplicable to state banks. Regulations relating to real estate lending found at 12 CFR 7.2000 *et seq.*, designed to assure compliance by national banks with federal law are also identified as being inapplicable to state banks, and on these matters state banks should refer to otherwise applicable state law.

The Office is not soliciting public comment with regard to these final amendments under authority of 5 U.S.C. 553(b), which authorizes waiver of public comment where public comment is impracticable or unnecessary. Such notice is impracticable because of the statutory deadline for publication of this notice and unnecessary because of the technical nature of the contents of this rulemaking. The amendments are made effective immediately pursuant to 5 U.S.C. 553(d)(2), which authorizes waiver of a delayed effective date. A delayed effective date is impracticable because of the statutory deadline governing publication of this notice.

Regulatory Impact Analysis

Pursuant to section 8(a)(2) of Executive Order 12291 (the "Order"), it has been determined that it is impracticable to comply with the requirements of section 3(c)(3) of the Order. Publication of this rule is required to be accomplished by December 14, 1982 under section 807(b)

of the Garn-St Germain Depository Institutions Act of 1982. Compliance with section 3(c)(3) of the Order would conflict with that statutory requirement. Publication of this document at an earlier date was not deemed necessary because extensive revisions to 12 CFR Part 29 were expected to be in effect by December 14, 1982. These revisions would have rendered this document unnecessary. Publication of these revisions, however, has not yet occurred, but is expected to occur in the near future.

Pursuant to section 3(g)(1) of the Order, it has been determined that the amendments do not constitute a major rule within the meaning of section 1(b) of the Executive Order. The amendments modify existing regulations to make them appropriate for use by state banks in making adjustable-rate mortgage loans, under the authority of Title VIII of the Depository Institutions Act of 1982. The amendments will have no adverse effect on the operations of the depository institutions subject to them. As such, the amendments will not have an annual effect on the economy of $100 million or more, will not affect costs or prices for consumers, individual industries, government agencies or geographic regions, and will not have adverse effects on competition, employment, investment, productivity, or on the ability of United States based enterprises to compete with foreign based enterprises in domestic or export markets.

Regulatory Flexibility Analysis

No regulatory flexibility analysis of these amendments is required under the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*) because no general notice of proposed rulemaking is required prior to implementation of these amendments.

List of Subjects in 12 CFR Part 29

Adjustable-rate mortgages, State banks.

PART 29—[AMENDED]

Accordingly, and pursuant to its authority under section 807(b) of Title VIII of the Garn-St Germain Depository Institutions Act of 1982, the Comptroller of the Currency amends 12 CFR Part 29 as follows:

1. The authority for Part 29 is revised as follows:

Authority: 12 U.S.C. 1 *et seq.*; sec. 708, Pub. L. 96-221, 94 Stat. 188 (12 U.S.C. 93a); sec. 711, Pub. L. 93-383, 88 Stat. 716 (12 U.S.C. 371(g)); and sec. 807(b), Pub. L. 97-320 (Garn-St Germain Depository Institutions Act of 1982).

2. Section 29.5(d)(2) is revised as follows:

§ 29.5 Rate changes.

* * * * *

(d) * * *

(2) Changing the rate of amortization, including utilization of a period or periods of negative amortization, is permissible only if (1) the payment is adjusted at least every 5 years to a level sufficient to amortize the outstanding principal at the interest rate then in effect over the remainder of the original loan term, which may not exceed 30 years in the case of national banks, and which may not exceed the limitations of state law in the case of state banks; and (2) the amount of negative amortization, if any, permitted during any such 5-year period does not exceed 1.0 percent of the principal outstanding at the beginning of that period multiplied by the number of whole consecutive 6-month periods included in the interval between payment changes. In no event may the amount of negative amortization allowed under the preceding sentence exceed 10.0 percent of the principal outstanding at the beginning of the period.

3. Section 29.11 is added as follows:

§ 29.11 Adjustable-rate mortgages by State banks.

State banks may, under authority granted by section 804(a)(1) of the Garn-St Germain Depository Institutions Act of 1982, make, purchase, and enforce adjustable-rate mortgages in accordance with the following provisions of this part: §§ 29.1, 29.2, 29.4, 29.5, 29.6, 29.7, and 29.8.

Dated: December 6, 1982.

C. T. Conover,

Comptroller of the Currency.

[FR Doc. 82-33948 Filed 12-13-82; 8:45 am]

BILLING CODE 4810-33-M

Regulations Issued by Comptroller of Currency

[¶ 3329] Part 29—Adjustable-Rate Mortgages

[CFR 12, c. 1, § 29 et seq.; added 46 Fed. Reg. 18932, eff. 3-27-81.]

[¶ 3329.1] § 29.1 **Purpose.**—This regulation is issued by the Office of the Comptroller of the Currency to establish rules for national banks making or purchasing adjustable-rate loans secured by liens on one- to four-family dwellings.

[¶ 3329.2] § 29.2 **Definition.**—An adjustable-rate mortgage loan is any loan made to finance or refinance the purchase of and secured by a lien on a one- to four-family dwelling, including a condominium unit, cooperative housing unit, or a mobile home, where such loan is made pursuant to an agreement intended to enable the lender to adjust the rate of interest from time to time. Adjustable-rate mortgage loans include loan agreements where the note and/or other documents expressly provide for adjusting the rate at periodic intervals. They also include fixed-rate loan agreements that implicitly permit rate adjustment by having the note mature on demand or at the end of an interval shorter than the term of the amortization schedule unless the national bank has clearly made no promise to refinance the loan (when demand is made or at maturity) and has made the disclosure specified in § 29.8(c).

[¶ 3329.3] § 29.3 **General rule.**—National banks may make or purchase adjustable-rate mortgage loans only if they conform to the conditions and limitations contained in this Part. National banks may make or purchase adjustable-rate mortgage loans pursuant to this Part without regard to any limitations that otherwise would be imposed on adjustable-rate mortgage lending by the laws of any State, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, or Guam, which limitations are hereby expressly preempted.

[¶ 3329.4] § 29.4 **Index.**—Changes in the interest rate charged on an adjustable-rate mortgage loan must be linked to changes in an index specified in the loan documents, *i.e.*, a 1 basis point (1 basis point = .01 percentage point) change in the index must be translated into a 1 basis point change of the same direction in the contract interest rate, except as otherwise provided in § 29.5. The index values used for the purpose of determining changes shall be either (1) the most recently available value on the date of loan origination or, provided the bank so specifies in its loan commitment, such earlier date on which a national bank enters into a binding commitment to lend at a specified starting interest rate and the values on subsequent dates for notifying borrowers of impending rate changes or (2) the moving averages on such dates of all values of an index over the interval from the prior rate-change notification date to the current rate-change notification date, using as the starting index value the moving average of index values over an equivalent interval ending with the date as of which the initial index value on the loan is determined. The index must be one of the following:

(a) The monthly average contract interest rate charged by all lenders on mortgage loans for previously occupied homes, as published by the Federal Home Loan Bank Board in its *Journal* and made available by the Federal Home Loan Bank Board in news releases on about the twelfth day of each month.

(b) The weekly or monthly average yield on United States Treasury securities adjusted to a constant maturity of 3 years. The weekly average yields are published in the *Federal Reserve Bulletin* and made available weekly by the Federal Reserve Board in Statistical Release H.15(519). The monthly average yields are published in the *Federal Reserve Bulletin* and made available by the Federal Reserve Board in Statistical Release G.13(415) during the first week of each month. *(Amended 47 Fed. Reg. 13775, eff. 4-1-82.)*

(c) The weekly average or the monthly average of weekly average auction rates on United States Treasury bills with a maturity of 6 months. The weekly average rates are published in the *Federal Reserve Bulletin* and made available weekly by the Federal Reserve Board in Statistical Release H.15(519). The monthly average yields are published in the *Federal Reserve Bulletin* and made available by the Federal Reserve Board in Statistical Release G.13(415) during the first week of each month. *(Amended 47 Fed. Reg. 13775, eff. 4-1-82.)*

If the national bank uses the 6-month Treasury bill rate index and adjusts interest rates less frequently than once every 6 months, then the bank must use the moving average, as described above, of the index values to measure interest rate changes.

[¶ 3329.5] § 29.5 Rate changes.—(a) *Frequency of Changes.* Interest rate changes on adjustable-rate mortgage loans may occur only at regular intervals of not less than 6 months, as specified in the loan documents. Notwithstanding the foregoing, a national bank may extend the length of the interval before the first potential interest rate change by any predetermined period.

(b) *Magnitude of Changes.* Interest rate adjustments to adjustable-rate mortgage loans may not exceed 100 basis points each 6 months. If the interval between interest rate changes exceeds 6 months, then the limitation on interest rate changes shall be 100 basis points multiplied by the number of whole consecutive 6-month periods in the interval between interest rate changes. In no event may any one interest rate change exceed 500 basis points. Notwithstanding the rules contained in this subsection, a national bank may decrease the contract rate of interest on an adjustable-rate mortgage loan at any time and by any amount beyond decreases required by the rules contained in his Part.

(c) *Required and Permitted Rate Changes.* Interest rate changes on adjustable-rate mortgage loans made or purchased by national banks shall be subject to the following additional restrictions:

(1) Interest rate increases permitted in accordance with the provisions of this Part shall be at the option of the bank.

(2) Interest rate decreases warranted by decreases in the index shall be mandatory except to the extent that rate increases in the index have not been implemented by the bank, either at its option or because of the limitation on increases specified in paragraph (b) of this section. If the bank agrees to impose a periodic or aggregate limitation on interest rate changes that is more restrictive than the limitation specified in paragraph (b) of this section, the same limitation shall apply to both increases and decreases.

(3) Banks offering adjustable-rate mortgage loans may establish in the loan documents any minimum interest rate change limitation and minimum increments of interest rate changes.

(4) Changes in the index not translated into changes in the interest rate because of the limitations contained in this Part or, consistent with this Part, at the discretion of the bank shall, to the extent not offset by subsequent movements of the index, be carried over and be available at succeeding rate-change dates.

(5) There shall be no charge by the national bank to the borrower, in the form of new closing cost, new processing fees, new finance charges, or similar fees, for any change in the interest rate on an adjustable-rate mortgage loan.

(d) *Method of Rate Changes.* (1) Interest rate changes to an adjustable-rate mortgage loan may be implemented through changes in the amount of the installment payment or the rate of amortization (*i.e.*, the amount, if any, of each installment payment allocated to repayment of principal) or any combination of these two methods, according to any schedule agreed upon by the borrower and the bank in the loan documents or as agreed upon by the parties at the time of any interest rate change. These methods are permissible regardless of any state-law prohibitions on the charging of interest on interest. Such prohibitions are expressly preempted, provided the interest rate charged by the national bank does not exceed the applicable usury limit, if any.

(2) Changing the rate of amortization, including utilization of a period or periods of negative amortization, is permissible only if (1) the payment is adjusted at least every 5 years to a level sufficient to amortize the outstanding principal at the interest rate then in effect over the remainder of the original loan term, which may not exceed 30 years; and (2) the amount of negative amortization, if any, permitted during any such period does not exceed 1.0 percent of the principal outstanding at the beginning of that period multiplied by the number of whole consecutive 6-month periods included in the interval between payment changes. In no event may the amount of negative amortization allowed under the preceeding sentence exceed 10.0 percent of the principal outstanding at the beginning of the period.

O—x [¶ 3329.6] § 29.6 **Prepayment fees.**—National banks offering or purchasing adjustable-rate mortgage loans must allow the borrowers to prepay in whole or in part without penalty at any time beginning 30 days before the first scheduled interest rate adjustment date. National banks offering or purchasing adjustable-rate mortgage loans may impose penalties for prepayments made prior to the date specified in the preceding sentence of this paragraph regardless of any state-law prohibitions of such fees, which prohibitions are expressly preempted.

O—x [¶ 3329.7] § 29.7 **Assumption.**—National banks offering or purchasing adjustable-rate mortgage loans are not required to allow those loans to be assumed by new purchasers of the mortgaged property, or to allow new purchasers to take title to such property subject to the lien of an adjustable-rate mortgage loan made pursuant to this Part, regardless of any limitations on the validity or enforceability of due-on-sale clauses found in state law, which limitations are expressly preempted. If a national bank does allow such a loan to be assumed or a purchaser to take title to property subject to the lien of an adjustable-rate mortgage loan made pursuant to this Part, the interest rate and any other loan terms may be reset as of the date of assumption. In order for an adjustable-rate mortgage loan to qualify for the benefits of this section, the loan note must contain a clause stating that the loan is due on sale or must contain some other provision indicating that the loan may be assumed or the property purchased subject to the bank's mortgage lien only at the bank's discretion.

O—x [¶ 3329.8] § 29.8 **Disclosure.**—(a) National banks offering adjustable-rate mortgage loans shall disclose in writing to a prospective borrower on the earlier of the date on which the bank first provides written information concerning residential mortgage loans available from the bank or provides a loan application form to the prospective borrower, the following items:

(1) The fact that the interest rate may change and a brief description of the general nature of an adjustable-rate mortgage loan;

(2) The index used, including the name of at least one readily available source in which it is published;

(3) A 10-year series updated at least annually showing the values of the index on at least a semiannual basis, presented in tabular form;

(4) The frequency with which the interest rate and payment levels will be adjusted, including provision for any extended interval before the first interest rate adjustment;

(5) Any rules relating to changes in the interest rate and/or installment payment amount;

(6) A description of the method by which interest rate changes will be implemented, including an explanation of negative amortization if it may occur in connection with the loan;

(7) The rules or conditions relating to refinancing of short-term and demand mortgage loans, prepayment, and assumption;

(8) A statement, if appropriate, that other fees will be charged by the bank and/or any other persons in connection with the adjustable-rate mortgage loan, including fees due at loan closing; and

(9) A schedule of the dollar amounts of the installment payments (principal and interest) on a $10,000 loan at a commitment rate offered by the bank within the preceding 12-month period if the mortgage interest rate were to increase as rapidly as possible, consistent with the interest rate limitations of the loan, by 10 percentage points (or by such lower aggregate interest rate limit as the bank may impose on its adjustable-rate mortgage loans).

Use of the optional model disclosure form provided in the Appendix to this Part, amended where necessary to describe accurately permissible variations found in the bank's adjustable-rate mortgage loans, will constitute compliance with this subsection.

(b) At least 30 days and no more than 45 days before any interest rate change may take effect, the bank must notify the borrower in writing of the following items:

(1) The current and proposed new interest rate;

(2) The base and current index values;

(3) The extent to which the bank has forgone any increase in the mortgage interest rate;

(4) The new monthly payment and/or other contractual effects of the rate change;

(5) The amount of the monthly payment, if different from that given in response to item 4, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term; and

(6) The fact that the loan may be prepaid at any time without penalty. Use of the optional notification form provided in the Appendix to this Part will constitute compliance with this subsection.

(c) A national bank making any loan to finance or refinance the purchase of, and secured by a lien on, a one- to four-family dwelling which is payable either on demand or at the end of a term which, including any terms for which the bank has promised to refinance the loan, is shorter than the term of the amortization schedule must include the following notice, displayed prominently and in capital letters, in or affixed to the loan application form and in or affixed to the loan note;

THIS LOAN IS PAYABLE IN FULL (AT THE END OF — YEARS OR ON DEMAND). (AT MATURITY OR IF THE BANK DEMANDS PAYMENT) YOU MUST REPAY THE ENTIRE PRINCIPAL BALANCE OF THE LOAN AND UNPAID INTEREST THEN DUE. THE BANK IS UNDER NO OBLIGATION TO REFINANCE THE LOAN AT THAT TIME. YOU WILL THEREFORE BE REQUIRED TO MAKE PAYMENT OUT OF OTHER ASSETS YOU MAY OWN,

OR YOU WILL HAVE TO FIND A LENDER WILLING TO LEND YOU THE MONEY AT PREVAILING MARKET RATES, WHICH MAY BE CONSIDERABLY HIGHER THAN THE INTEREST RATE ON THIS LOAN.

Fixed-rate short-term or demand loans for which this notice has been properly given will not be characterized as adjustable-rate mortgage loans.

(d) No later than the date on which a national bank establishes the initial index value, it must inform the borrower of this base index value against which interest rate changes will be measured. This base value must be included in the note which the borrower signs, and the borrower must be given a copy of this note no later than closing. *(Amended 47 Fed. Reg. 13775, eff. 4-1-82.)*

[¶ 3329.9] § 29.9 **Certain payment-capped mortgages.**—(a) *Authority to Lend, Subject to Review by Comptroller.* The limitations imposed by this Part shall not apply to adjustable-rate mortgage loans which contain meaningful limitations on the magnitude of permissible changes in the amount of installment payments that offer borrowers sufficient protection against payment volatility. The Office of the Comptroller of the Currency may at any time require a national bank to modify or terminate a loan program qualifying under this subsection if it is determined that the program does not adequately provide for repayment of the loans in a timely manner or that the program does not sufficiently protect borrowers against payment volatility.

(b) *Prior Notice of New Programs.* Before a national bank initiates an adjustable-rate mortgage loan program pursuant to this subsection, it must send a copy of all program loan documents and disclosure forms to Chief National Bank Examiner, Office of the Comptroller of the Currency, Washington, D.C. 20219. If the Office of the Comptroller of the Currency has not required the bank in writing to modify or abandon the program within 60 days from the date on which the documents were postmarked or similarly marked as having been sent to the address given above, the bank may proceed with the program.

(c) *Notice of Existing Programs.* Notwithstanding the transition rule contained in § 29.10, if on the effective date of this rule a national bank has already made a loan or a binding commitment to lend under a program qualifying under this subsection, the bank may continue to make loans under such program but must immediately send a copy of the documents described above in subsection (b) to the address above. The Office of the Comptroller of the Currency may subsequently require modification or termination of the program in accordance with the provisions of this section.

(d) *Program Modifications.* Substantively modified programs shall be regarded as new programs for the purpose of this section.

[¶ 3329.10] § 29.10 **Transition rule.**—If on the effective date of this rule a national bank has already made a loan or a binding commitment to lend under an adjustable-rate mortgage loan program which would violate any of the provisions of this Part, the national bank may continue to make loans or binding commitments to lend under the program for 120 days from the effective date of this rule before the program must be brought into conformity with all of the provisions of this Part.

[¶ 3329.20] **Appendix**

A. Model Form for Initial Adjustable-Rate Mortgage Disclosure

Important Mortgage Loan Information—Please Read Carefully

If you wish to apply for an Adjustable-Rate Mortgage (ARM) loan with ———— National Bank, you should read the information below concerning the difference between this mortgage and other mortgages with which you may be familiar.

General Description of Adjustable-Rate Mortgage Loan

THE LOAN OFFERED BY ———— NATIONAL BANK IS AN ADJUSTABLE-RATE MORTGAGE. ITS INTEREST RATE WILL CHANGE [fill in frequency] BASED ON MOVEMENTS OF AN INTEREST RATE INDEX. YOUR MONTHLY PAYMENTS WILL INCREASE IF THE INTEREST RATE RISES OR DECREASE IF THE INTEREST RATE FALLS. BECAUSE FUTURE MOVEMENTS OF THE INDEX ARE RELATED TO MARKET CONDITIONS THAT CANNOT BE PREDICTED, IT IS IMPOSSIBLE TO KNOW IN ADVANCE HOW MUCH YOU WILL HAVE TO PAY, EITHER EACH MONTH OR OVER THE LIFE OF THE LOAN. INTEREST RATE AND PAYMENT CHANGES WILL BE MADE ACCORDING TO CERTAIN RULES THAT ARE EXPLAINED BELOW.

Key Terms of ———— National Bank's Adjustable Rate Mortgage

The following outline of the terms on ARM's offered by ———— National Bank is intended for easy reference only. You will find other essential information in this disclosure statement and in the loan note itself.

Loan term .....
Frequency of rate changes .....
*[Grace period before first rate change .....]
Interest rate index .....
Maximum rate change at one time .....
Maximum rate change over life of loan .....
*[Minimum rate change at one time .....]
*[Minimum increments of rate change .....]
*[Prepayment fee .....]
Assumability (assumable, not assumable or at lendor's discretion) .....
Possibility of increasing loan balance [yes or no] .....

How Your Adjustable-Rate Mortgage Would Work

Starting Interest Rate

The starting interest rate offered by ———— National Bank on an ARM will be specified [at loan closing, when we make a loan commitment to you, other] based on market conditions at that time.

Frequency of Interest Rate Changes

Your interest rate will be reviewed every ——— beginning ——— after the date on which you take out your loan, and may increase or decrease at those times based on changes in the index.

Index for Measuring Interest Rate Changes

The index to which your interest rate will be tied is ———.

Information on this index is published monthly in ———. The table below shows a ten-year history of movements of this index. This does not necessarily indicate how the index may perform in the future.

10-Year History of ———— Index

Date	Index	Change from preceding rate
1/1/x0		
7/1/x0		
1/1/x1		
• • • • • • • • • • • •		
7/1/x9		

Size of Interest Rate Changes

The interest rate on your ARM will increase or decrease based on movements in the index. A change in the index of 1 percentage point will be translated into a 1

* Bracketed items and footnotes are instructions to national banks or contain optional language to be selected as appropriate

percentage point change of the same direction in your ARM interest rate. However, no single change in the interest rate will be more than —— percentage points no matter how much the index may have moved. [Also, there will be no change in your interest rate if the index moves less than —— percentage points.] All changes will be in increments of —— percentage points.]

Mandatory and Optional Rate Changes

Decreases in your interest rate warranted by decreases in the index will always

PROPOSED COMPTROLLER OF THE CURRENCY REGULATIONS, JUNE 2, ON EASING RESTRICTIONS ON ISSUANCE OF ADJUSTABLE-RATE MORTGAGES BY NATIONAL BANKS

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 29

[Docket No. 82-9]

Adjustable-Rate Mortgages

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Proposed rule.

SUMMARY: The Office of the Comptroller of the Currency (Office) is proposing revisions to its adjustable-rate mortgage (ARM) regulation (12 CFR Part 29). That regulation was published on March 27, 1981 and amended on April 1, 1982. The proposed revisions would increase the flexibility of national banks to design ARM instruments by eliminating (1) limits on the frequency of payment and interest rate adjustments and (2) limits on the magnitude of interest rate adjustments. The proposal would replace the requirement that the monthly payment be reset at a fully amortizing level at least once every five years with a requirement that the monthly payment be reset at a level sufficient to begin reducing the outstanding debt no later than during the 21st year. The proposal would retain (1) the requirement that changes in the ARM interest rate be tied to changes in an interest rate index and (2) most of the existing disclosure requirements. The revised regulation would result in a freer flow of bank funds into home mortgage lending and would eliminate the reporting requirement associated with payment-capped mortgage plans.

DATE: Comments on the proposed regulation must be received on or before July 2, 1982.

ADDRESS: Comments should be sent to Docket No. 82-9, Communications Division, Office of the Comptroller of the Currency, Washington, D.C. 20219, Attn: Marie Giblin. Telephone (202) 447-1800. Comments will be available for public inspection and photocopying.

FOR FURTHER INFORMATION CONTACT: Judith Naiman, Industry and Public Affairs, (202) 447-0934, David Nebhut, Economic and Policy Research Division, (202) 447-1825, or Francis S. Rath, Legal Advisory Services Division, (202) 447-1880, Office of the Comptroller of the Currency, Washington, D.C. 20219.

SUPPLEMENTARY INFORMATION:

Drafting Information

The principal drafter of this document was David Nebhut, Financial Economist, Economic and Policy Analysis Division, Office of the Comptroller of the Currency.

Special Analyses

The Secretary of the Treasury has expressly exempted this regulation from the requirement of preparing a regulatory flexibility analysis, since it will not have a significant economic impact on a substantial number of small entities. The revised regulation is expected to result in a freer flow of bank funds into home mortgage lending and will eliminate the reporting requirement associated with payment-capped mortgage plans. Any costs incurred by small banks as a result of the revision are likely to result from adjustments in computer programs and employee training. Those costs are expected to be minimal.

The Office of the Comptroller of the Currency has determined that the regulation does not constitute a major rule within the meaning of E.O. 12291. Accordingly, a regulatory impact analysis will not be prepared on the grounds that the proposed revision (1) will not have an annual effect on the economy of $100 million or more, (2) will not result in a major increase in the cost of bank operations or government supervision nor is it likely to generate substantially higher payment for borrowers, and (3) will not have a significant adverse effect on competition, employment, investment, productivity, innovation, or competition with foreign-based entities.

Two proposed modifications of the regulation are the removal of interest rate caps and the removal of the limit on negative amortization. The current regulation permits interest rate increases in excess of the periodic caps to be carried over to future time periods. Therefore, the removal of the interest rate caps should have a relatively small effect on the overall amount that a borrower will pay over the life of the mortgage. However, removal of the caps, if not accompanied by a limitation on the size of payment changes, will increase the potential payment volatility of mortgage loans that provide for frequent payment changes. The removal of interest rate caps from the regulation does not preclude the imposition of caps by lenders. Lenders may choose to design instruments with interest rate caps in order to limit their credit risk.

The likely effect of the removal of the limit on negative amortization is more complicated to evaluate, but the Office believes that the removal of the limit will not substantially increase the cost of a loan relative to the amount actually borrowed. Negative amortization, in effect, means that the lender is advancing a portion of the interest due in a given month to the borrower. Therefore, higher payments on a loan that has had higher negative amortization are analogous to higher payments required to repay a larger principal balance. Further, increasing the amount of permissible negative amortization will enable borrowers to realize reduce monthly payments for some portion of the loan term.

Overall, the revision of the regulation will enhance the competitive position of national banks by permitting them to develop ARM instruments that are responsive to borrower needs.

Background and Analysis

On March 27, 1981, the Office adopted a final rule (46 FR 18932) establishing a framework within which national banks may make or purchase mortgage instruments that are responsive to changing interest rates and to bank deposit structures. That rule provided sufficient flexibility to accommodate most adjustable-rate mortgage lending programs then in existence. To promote continued innovation and experimentation, the rule permitted national banks to submit for review by the Office of the Comptroller of the Currency adjustable-rate mortgage plans that limit payment changes and provide for timely repayment of the loan but do not cap interest rate adjustments.

Since June 1981, the Office has permitted approximately 30 national banks to offer adjustable-rate mortgages that incorporate features not authorized by the ARM regulation. Most of the nonconforming ARM programs contain no caps on interest rates or on negative amortization and some use interest rate indexes not authorized by the Office's regulation. Instead of requiring changes in the design of those programs, the Office informed the banks of its concerns with such flexible instruments and permitted loans to be originated under those programs on an experimental basis.

The ARM rule was issued as an interim measure intended to smooth the transition from a market involving almost exclusively level-payment, fixed-rate mortgage loans to a market with a variety of flexible mortgage instruments. The Office anticipated reexamining the regulation two years after it was issued. However, the movement from standard fixed-rate mortgages to a variety of alternative mortgage instruments including ARMs, shared-appreciation

mortgages, and mortgages designed to accelerate repayment of principal occurred more rapidly than expected.

Several factors are responsible for the rapid change in the ARM market. One factor is the increased flexibility under which other mortgage lenders operate. On April 30, 1981, the Federal Home Loan Bank Board (FHLBB) issued a regulation (46 FR 24148) permitting federally chartered savings and loan associations to offer a wide variety of adjustable mortgage loan instruments. That regulation neither restricts interest rate adjustments nor limits increases in the outstanding loan balance on mortgage loans made by federally chartered S&Ls. On July 29, 1981, the National Credit Union Administration (NCUA) issued a similar regulation (46 FR 38669) governing ARM lending by federally chartered credit unions and the FHLBB amended its regulation to permit graduated-payment adjustable mortgage loans. A number of states now permit state-chartered financial institutions to make ARMs that are more flexible than those permitted by the Office's regulation. Additionally, private mortgage insurers have shown their willingness to insure ARMS that are more flexible than those the Office's regulation permits.

A second factor contributing to the development of the ARM market has been the creation of a secondary market in adjustable-rate mortgages. In June 1981, the Federal National Mortgage Association (FNMA) announced plans to purchase eight different types of ARMs. Of those eight, only two are consistent with the Office's current regulation. The six plans that national banks may not originate, except perhaps as payment-capped mortgages, do not have interest rate caps. Also, some permit more negative amortization than the regulation permits, and others use indexes not authorized by the Office.

The Office has permitted several national banks to offer four of the nonconforming FNMA plans under the provisions of the ARM regulation that permit experimentation with payment-capped mortgages. That process, however, involves delays in reviewing and responding to individual bank's submissions and could limit the ability of national banks to compete in the adjustable-rate mortgage market. The Office is, therefore, considering revising the regulation to authorize national banks to offer more flexible adjustable-rate mortgages.

The proposed revision to the regulation is consistent with the Office's belief that the design of adjustable-rate mortgage instruments can best be determined by the marketplace rather than by regulation. A lender's needs may depend on its deposit base, the customers it serves, the demands of secondary mortgage market investors, and the economic conditions of its region. Similarly, borrowers with differing expectations of income growth and differing preferences for housing are likely to demand different mortgage instruments. Lending institutions must have flexibility in designing mortgage instruments if the housing finance needs of various participants in the market are to be met.

Market imperfections, however, may prevent the efficient operation of a totally unregulated ARM market. The primary market imperfection is the high cost of obtaining information on an ARM. Those costs may prevent borrowers from accurately evaluating the instruments available. That problem can be compounded by the high transaction costs associated with mortgage loans that tend to lock borrowers into contracts, even if it is discovered after a contract is closed that a particular loan does not meet their needs. The Office's proposal addresses those problems in two ways. First, the requirement that the ARM interest rate be indexed to a market interest rate ensures that ARM interest rate changes are based on objective indicator of market conditions. This protects borrowers from arbitrary increases in the loan rate. Second, in recognition of the complexity of adjustable-rate mortgages, the proposal retains the requirement that banks disclose basic information to potential borrowers on the operation of the adjustable-rate mortgages it offers.

Proposed Changes in the OCC's ARM Regulation

Proposed changes in the OCC's ARM regulation are discussed below. No changes are proposed in the provisions of the regulation that are not addressed in this section.

Index

The proposed revision to the regulation permits national banks to use as an interest rate index any interest rate (or a moving average thereof) that is readily available to and verifiable by borrowers, and is beyond the control of the bank. If a bank bases interest rate changes on movements in a published average cost-of-funds index, it would be required to include in the disclosure notice a statement that such an index is likely to exhibit an upward bias over the next several years, regardless of movements in market rates of interest, as the interest rate ceilings on deposit instruments are phased out.

The Office's current adjustable-rate mortgage regulation (as amended on April 1, 1982 at 47 FR 13775) authorizes five interest rate indexes: the monthly and weekly average of the average auction rate on 6-month Treasury bills, the monthly and weekly average yield on Treasury securities with a maturity of three years, and the monthly average contract rate on previously occupied homes as complied by the Federal Home Loan Bank Board.

The Office limited the choice of indexes in its regulation in order to provide some uniformity in the ARM market, to simplify borrower comparisons of different ARM programs, and to facilitate the development of a secondary market in adjustable-rate mortgages. However, since FHLBB, NCUA and FNMA permit additional interest rate indexes, it is unlikely that continuing to limit the number of permissible indexes for national banks will promote uniformity in the adjustable-rate mortgage market or facilitate comparison shopping by potential borrowers.

The Office seeks comments on: (1) Whether there are any interest rate indexes that meet the proposed criteria but would be inappropriate interest rate indexes and (2) whether the above criteria exclude any interest rate indexes that would be appropriate.

Interest Rate Changes

(a) *Frequency.* The proposal removes (1) the limits on the frequency of interest rate adjustments and (2) the requirement that interest rate adjustments occur at regular intervals. It requires only that interest rate changes occur at intervals specified in the loan documents. The proposal retains the requirement that the borrower be notified of an impending interest rate adjustment 30 to 45 days before any interest rate adjustment may take effect.

The Office's existing regulation limits the frequency of interest rate adjustments to regular intervals of not more than once every 6 months. The initial fixed-rate period may exceed subsequent fixed-rate periods.

The limitation was included in the regulation to give borrowers some minimum period of payment stability. However, payments can be stabilized without restricting the frequency of interest rate changes, *e.g.*, the rate of amortization can be changed while the payment remains constant. To the extent that interest rate changes are cyclical, such an adjustment technique enables the lender to implement interest rate changes without deviating greatly from the original amortization schedule. Secular increases in the interest rate,

however, would necessitate an eventual payment increase.

The Office requests comment on: (1) Whether the constraint on the frequency of interest rate adjustments should be retained and (2) the likely effect of its removal.

(b) *Magnitude.* The proposed amendment eliminates limits on the size of interest rate adjustments. The existing ARM rule limits interest rate adjustments to not more than 1 percentage point per six month period between adjustments and to not more than 5 percentage points at any single rate adjustment.

Regulatory constraints on the magnitude of interest rate changes impose some interest rate risk sharing between borrower and lender and dampen the potential volatility of monthly payments. At present market rates, the ARM interest rate cap implies a maximum annual payment change of approximately 15%.

The Office seeks comments on whether limitations on interest rate adjustments should be eliminated from the regulation.

An alternative to requiring interest rate caps is to give national banks the option of choosing either a periodic interest rate cap or a periodic cap on monthly payment changes. The Office seeks comments on whether any such requirement would be appropriate.

(c) *Required and Permitted Changes.* The existing regulation requires that any periodic or aggregate limit on interest rate changes apply to both increases and decreases. The proposal removes that requirement.

Lenders offering ARMs have designed a number of instruments with interest rate increases and decreases that are not symmetrical. For example, an ARM may have an initial interest rate which is below the current market rate. To compensate the lender, a schedule is established at the outset that will increase the mortgage interest rate by increasing the spread between the loan rate and the index rate. During this graduation period, decreases in the interest rate that might otherwise have resulted from decreases in the index are not taken. The Office believes that national banks should have the ability to design instruments with such flexibility, provided that the schedule for interest rate and payment adjustments is explained clearly and accurately in the initial disclosure statement. The Office requests comments on: (1) The likely effect of removing the symmetry requirement and (2) whether the regulation should specify required and permitted interest rate changes.

(d) *Negative Amortization.* The proposed amendment does not change the permissible methods of implementing interest rate changes. It does, however, remove the restriction on the aggregate amount of negative amortization that may occur on an ARM made by a national bank. Banks are, however, required to set the installment payment at a level sufficient to begin reducing the outstanding loan principal no later than during the 21st year of the loan term and to amortize the entire principal of the loan without a substantial balloon payment by the end of the 30th year.

The Office's existing regulation permits interest rate changes to be implemented through changes in the monthly payment, changes in the rate of amortization, or a combination of those methods. Negative amortization is now limited to one percent of the outstanding loan balance at the beginning of a fixed-payment period times the number of 6-month periods between payment adjustments. Additionally, the monthly payment must be set at a fully amortizing level at least once every 5 years.

Negative amortization is an essential element of any graduated-payment mortgage. In the early years of the loan, the borrower's monthly payments are set at a level below that required to amortize the loan. During that period, the bank, in effect, lends the borrower the difference between the actual monthly payment and the payment required for full amortization of the loan. The higher monthly payments later in the loan term compensate the lender for the earlier period of negative or reduced amortization. A key feature of a graduated-payment mortgage loan is a predetermined schedule of payment increases designed to put the loan on a fully amortizing basis at the end of a specified period.

On other ARMs, negative amortization provides a cushion that enables borrowers to maintain level payments beyond the period for which the interest rate is fixed. Cyclical movements in the interest rate alter the rate of amortization rather than the size of monthly payments. If significant periods of negative amortization occur, the loan-to-value ratio may rise, which in turn increases the lender's risk.

The Office requests comment on whether the regulation should include any limits on negative amortization or guidelines to assure that the loan-to-value ratios on ARMs do not exceed an unsafe level.

Fees

The proposal does not prohibit fees for rate or payment adjustments or prepayment of principal. Lenders that charge such fees would be required to disclose the size of the fees and when and how such fees would be charged. The Office's existing adjustable-rate mortgage regulation prohibits charges for interest rate or payment adjustments and permits prepayment fees only up until 30 days before the first rate adjustment on an ARM.

The Office seeks comments on the desirability of permitting banks to charge fees for interest rate adjustments, payment adjustments, and prepayments. Also, the Office specifically requests comments on whether prepayment fees should be permitted if prepayments arise via accelerated amortization due to the nature of the ARM program.

Disclosure. (a) The proposed revision retains most of the disclosure requirements of the existing regulation. Listed below are the changes in the required disclosures.

(1) Banks using an average cost-of-funds index would be required to disclose that such an index is likely to have an upward bias as the phasing out of interest rate ceilings on depository instruments continues.

(2) The proposal requires lenders to describe the method used to calculate the initial monthly payment on the loan if it differs from the fully amortizing monthly payment.

(3) The proposal does not prohibit lenders from charging fees related to interest rate adjustments, changes in the monthly payment, or prepayment on an ARM. Lenders would be required to disclose on what basis such fees would be charged and the amount of such fees.

(4) The proposal revises the required hypothetical example that national banks must provide. The regulation stipulates an interest rate scenario that increases by 10 percentage points as rapidly as possible. The proposal requires each bank to determine the interest rate scenario to be used with its example. Comments are requested on whether the Office should specify an interest rate scenario to be used by all national banks offering ARMs and, if so, what rate scenario might be appropriate.

(5) Because the proposal greatly expands the variety of instruments that national banks may offer, it is unlikely that a single disclosure form would be suitable for all ARMs. The proposal, therefore, does not include a model disclosure form. Nevertheless, banks are required to explain to their borrowers the potential risks of ARMs. Disclosure documents will be tailored by the bank according to its ARM plan. Comments are requested on whether the provision of a model form by this Office is necessary and, if so, how a model

disclosure form might be designed to accommodate the variety of ARMs that will appear on the market.

(6) The proposal authorizes national banks to offer ARMs on which payment changes occur at different intervals than interest rate changes. Therefore, the Office is proposing that payment adjustment notifications be provided at least 30 days and no more than 45 days before any payment change may take effect and that certain information be included in such notifications. The Office requests comments on whether payment change notification requirements should be included in the regulation.

(b) The proposal does not substantially alter the disclosure statement that national banks making short-term demand or balloon mortgages must provide to borrowers. The Office believes that statement conveys important information. The Office solicits comments on whether the wording and the tone of that statement are appropriate and whether it provides borrowers with accurate and meaningful information regarding the nature of such loans.

List of Subjects in 12 CFR Part 29

National banks, Mortgages.

Proposed Amendment

Accordingly, the Office proposes to revise 12 CFR Part 29 to read as follows:

PART 29—ADJUSTABLE-RATE MORTGAGES

Sec.

Authority: 12 U.S.C. 1 *et seq.*; 12 U.S.C. 93a; and 12 U.S.C. 371(g).

§ 29.1 Definition

An adjustable-rate mortgage loan is any loan made to finance or refinance the purchase of and secured by a lien on a one- to four-family dwelling, including a condominium unit, cooperative housing unit, or a mobile home, where such loan is made pursuant to an agreement intended to enable the lender to adjust the rate of interest from time to time. Adjustable-rate mortgage loans include loan agreements where the note and/or other loan documents expressly provide for adjusting the rate at periodic intervals. They also include fixed-rate loan agreements that implicitly permit rate adjustment by having the note mature on demand or at the end of an interval shorter than the term of the amortization schedule unless the national bank has clearly made no promise to refinance the loan (when demand is made or at maturity) and has made the disclosure specified in § 29.7(d).

§ 29.2 General rule.

National banks may make or purchase adjustable-rate mortgage loans only if they conform to the conditions and limitations contained in this part. National banks may make or purchase adjustable-rate mortgage loans pursuant to this Part without regard to any limitations that otherwise would be imposed on adjustable-rate mortgage lending by the laws of any State, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, or Guam, which limitations are hereby expressly preempted.

§ 29.3 Index.

Changes in the interest rate charged on an adjustable-rate mortgage loan must be linked to changes in the index specified in the loan documents, *i.e.*, a 1 basis point (1 basis point =.01 percentage point) change in the index must be translated into a 1 basis point change of the same direction in the contract interest rate except as otherwise provided in § 29.4(b). A national bank may use as an interest rate index any measure of market rates of interest that is readily available to and verifiable by the borrower and is beyond the control of the bank. The index for an adjustable-rate mortgage loan shall be either single values of the chosen measure or a moving average of the chosen measure calculated over a specified period. The initial index value shall be the most recently available index value on the date that the lender commits to the initial interest rate on the loan. Subsequent interest rate changes shall be based on the most recently available index value at the date for notifying borrowers of impending changes in the interest rate.

§ 29.4 Rate changes.

(a) *Frequency of changes.* Interest rate changes on an adjustable-rate mortgage loan shall occur at intervals specified in the loan documents.

(b) *Required and permitted rate changes.* Interest rate changes on adjustable-rate mortagage loans shall be subject to the following provisions:

(1) Interest rate increases permitted in accordance with this Part shall be at the option of the bank.

(2) Interest rate decreases warranted by decreases in the index shall be mandatory except to the extent they would exceed limitations established pursuant to § 29.4(b)(3); to the extent that rate increases fully reflecting increases in the index have not been implemented by the bank, either at its option or because of limitations on interest rate adjustments as permitted in § 29.4(b)(3); or to the extent that the bank has previously voluntarily reduced the interest rate on an adjustable-rate mortgage loan.

(3) Banks offering adjustable-rate mortgage loans may establish in the loan documents limitations on maximum or minimum interest rate increases or decreases, minimum increments of interest rate increases or decreases, and procedures for rounding the interest rate on the loan to the nearest percentage point or some fraction thereof.

(4) Voluntary interest rate reductions not related to index changes and changes in the index that do not result in equal changes in the interest rate (including differences between changes in the index rate and changes in the interest rate due to rounding) shall, to the extent not offset by subsequent movements of the index, be carried over and be available at succeeding rate change dates.

(5) A national bank may decrease the contract rate on an adjustable-rate mortgage at any time and by any amount beyond the decreases required by the rules contained in this Part.

(c) *Method of rate changes.* Interest rate changes to an adjustable-rate mortgage loan may be implemented through changes in the amount of the installment payment or the rate of amortization or any combination of these two methods, according to a schedule agreed upon by the borrower and the bank in the loan documents or as agreed upon by the parties at the time of an interest rate change. Notwithstanding the foregoing, installment payments shall be required for an adjustable-rate mortgage loan that are sufficient to reduce the outstanding principal balance of the loan beginning no later than during the twenty-first year and are sufficient to amortize the entire principal of the loan without a substantial ballon payment by the end of the thirtieth year. These methods are permissible regardless of any state-law prohibitions on the charging of interest on interest. Such prohibitions are expressly preempted, provided the interest rate charged by the national bank does not exceed the applicable usury limit, if any.

§ 29.5 Prepayment fees.

National banks offering or purchasing adjustable-rate mortgage loans may impose penalties for prepayments regardless of any state-law prohibitions of such fees, which prohibitions are expressly preempted.

§ 29.6 Assumption.

National banks offering or purchasing adjustable-rate mortgage loans that include due-on-sale clauses are not required to allow those loans to be assumed by new purchasers of the mortgaged property or to allow new purchasers to take title to such property subject to the lien of an adjustable-rate mortgage loan made pursuant to this Part, regardless of any limitations on the validity or enforceability of due-on-sale clauses found in state law, which limitations are expressly preempted. If a national bank does allow such a loan to be assumed or a purchaser to take title to property subject to the lien of an adjustable-rate mortgage loan made pursuant to this Part, the interest rate and any other loan terms may be reset as of the date of assumption. In order for an adjustable-rate mortgage loan to qualify for the benefits of this section, the loan note must contain a clause stating that the loan is due on sale or must contain some other provision indicating that the loan may be assumed or the property purchased subject to the bank's mortgage lien only at the bank's discretion.

§ 29.7 Disclosure.

(a) A national bank offering adjustable-rate mortgage loans shall disclose in writing on the earlier of the date on which the bank first provides written information concerning adjustable-rate mortgage loans available from the bank or provides a loan application form to the prospective borrower, the following items:

(1) The fact that the interest rate may change and a brief description of the general nature of an adjustable-rate mortgage loan;

(2) The index used, including the name of at least one readily available source in which it is published. If the index is based on a cost of funds rate for any group of financial institutions subject to limitations on the interest they may pay certain classes of depositors, a bank must describe that fact and point out that the removal of interest rate ceilings will likely result in an upward bias on future movements of the index, regardless of movements in market interest rates;

(3) A 10-year series updated at least annually showing the values of the index on at least a semiannual basis, presented in a table. The table should show either single values of the measure of interest rates or an average of single values, consistent with the bank's adjustable-rate mortgage loan program;

(4) The frequency with which the interest rate and payment levels will be adjusted;

(5) The method used to calculate the initial monthly payment, if that payment differs from the fully amortizing payment;

(6) Any rules relating to changes in the interest rate, installment payment amount, and/or increases in the outstanding loan balance;

(7) A description of the method by which interest rate changes will be implemented, including an explanation of negative amortization and balloon payments, if they may occur in connection with the loan;

(8) A statement, if appropriate, of the rules or conditions relating to refinancing of short-term and demand mortgage loans, prepayment, and assumption;

(9) A statement, if appropriate, of fees that will be charged by the bank and/or any other persons in connection with the adjustable-rate mortgage loan, including fees due at loan closing, prepayment fees and fees that will be charged for interest rate or payment adjustments and a statement of when and how such fees will be charged;

(10) A schedule of the dollar amounts of the installment payments (principal and interest), and the outstanding loan balance at each payment adjustment date on a $10,000 adjustable-rate mortgage loan that might occur under the bank's adjustable-rate mortgage loan program. The initial interest rate should be a commitment rate offered by the bank within the preceding 12-month period.

(b) At least 30 days and no more than 45 days before any interest rate change may take effect, the bank must notify the borrower in writing of the following items:

(1) The current and proposed new interest rate;

(2) The base index value and the index values upon which the current interest rate and the new interest rate are based;

(3) The extent to which the bank has forgone any increase in the mortgage interest rate;

(4) The monthly payment due after implementation of the interest rate adjustment and/or other contractural effects of the rate change;

(5) The amount of the monthly payment, if different from that given in response to item 4, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term;

(6) The amount of the prepayment penalty, if any, that will be charged if the borrower chooses to prepay the loan rather than accept an interest rate increase.

(c) If under the bank's adjustable-rate mortgage program, a payment change may occur at a different date than an interest rate change, at least 30 days and no more than 45 days before any such payment change may take effect, the bank must notify the borrower in writing of the following items:

(1) An explanation of the circumstances that have led to such a payment change;

(2) The monthly payment due after implementation of the payment adjustment;

(3) The amount of the monthly payment, if different from that given in response to item 2, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term;

(4) The amount of any prepayment penalty that will be charged if the borrower chooses to prepay the loan.

(b) A national bank making any loan to finance or refinance the purchase of and secured by a lien on a one- to four-family dwelling which is either payable on demand or at the end of a term which, including any terms for which the bank has promised to refinance the loan, is shorter than the term of the amortization schedule, must include the following notice displayed prominently and in capital letters in or affixed to the loan application form and in or affixed to the loan note:

THIS LOAN IS PAYABLE IN FULL [AT THE END OF —— YEARS *or* ON DEMAND]. [AT MATURITY *or* IF THE BANK DEMANDS PAYMENT] YOU MUST REPAY THE ENTIRE PRINCIPAL BALANCE OF THE LOAN AND UNPAID INTEREST THEN DUE. THE BANK IS UNDER NO OBLIGATION TO REFINANCE THE LOAN AT THAT TIME. YOU WILL THEREFORE BE REQUIRED TO MAKE PAYMENT OUT OF OTHER ASSETS YOU MAY OWN, OR YOU WILL HAVE TO FIND A LENDER WILLING TO LEND YOU THE MONEY AT PREVAILING MARKET RATES, WHICH MAY BE CONSIDERABLY HIGHER THAN THE INTEREST RATE ON THIS LOAN. IF YOU REFINANCE THIS LOAN AT MATURITY, YOU MAY HAVE TO PAY SOME OR ALL CLOSING COSTS NORMALLY ASSOCIATED WITH A NEW LOAN, EVEN IF YOU OBTAIN REFINANCING FROM THE SAME BANK.

Fixed-rate short-term or demand loans for which this notice has been properly given will not be characterized as adjustable-rate mortgage loans.

(e) At the date on which the initial interest rate on an adjustable-rate mortgage loan is determined, the bank must inform the borrower of the initial index value against which interest rate changes will be measured. This initial index value must be included in the note which the borrower signs. The borrower must be given a copy of that note no later than at loan closing.

Dated: May 4, 1982.

C. T. Conover,

Comptroller of the Currency.

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