be viewed at the following web site: http://www.ams.usda.gov/fv/moab.html. Any questions about the compliance guide should be sent to Jay Guerber at the previously mentioned address in the **FOR FURTHER INFORMATION CONTACT** section.

A 60-day comment period is provided to allow interested persons to respond to this proposal.

List of Subjects in 7 CFR Part 984

Marketing agreements, Nuts, Reporting and recordkeeping requirements, Walnuts.

For the reasons set forth in the preamble, 7 CFR part 984 is proposed to be amended as follows:

PART 984—WALNUTS GROWN IN CALIFORNIA

1. The authority citation for 7 CFR part 984 continues to read as follows:

Authority: 7 U.S.C. 601–674.

2. A new § 984.459 is added to read as follows:

§ 984.459 Reports of interhandler transfers.

(a) Any handler who transfers walnuts to another handler within the State of California shall submit to the Board, not later than 10-calendar days following such transfer, a report showing the following:

(1) The date of transfer;

(2) The net weight, in pounds, of the walnuts transferred;

(3) Whether such walnuts were certified by the inspection service;

(4) Whether such walnuts were inshell or shelled;

(5) The name and address of the transferring handler; and

(6) The name and address of the receiving handler.

(b) The transferring handler shall send two copies of the report to the receiving handler at the time the report is submitted to the Board. The receiving handler shall certify, on one copy of the report, to the receipt of such walnuts and submit it to the Board within 10-calendar days after the walnuts, or copies of such report, have been received, whichever is later.

Dated: March 30, 2000.

Robert C. Keeney,

Deputy Administrator, Fruit and Vegetable Programs.

[FR Doc. 00–8300 Filed 4–4–00; 8:45 am]

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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 560

[No. 2000–34]

RIN 1550–AB37

Responsible Alternative Mortgage Lending

AGENCY: Office of Thrift Supervision, Treasury

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Office of Thrift Supervision (OTS) is reviewing its mortgage lending regulations to determine their effect in today's markets on not only savings associations and their customers but also on state-regulated housing creditors who may be making alternative mortgage transactions under the Alternative Mortgage Transactions Parity Act and their customers. This advance notice of proposed rulemaking (ANPR) seeks public input on questions OTS will consider as part of that review. OTS could pursue a variety of regulatory approaches to help ensure that the lending regulations are meeting the purposes for which they were intended: encouraging the safe and sound, efficient delivery of low-cost credit to the public free from undue regulatory duplication and burden. The agency welcomes comments on the advantages, disadvantages, and potential interactions and side effects of various approaches. The agency is particularly interested in public input on potential approaches that will facilitate thrifts? efforts to responsibly address the lending needs of traditionally underserved markets, consistent with safe and sound operation.

DATES: Comments must be received on or before July 5, 2000.

ADDRESSES: Please send comments to Manager, Dissemination Branch, Information Management and Services Division, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention Docket No. 2000–34. Hand deliver comments to 1700 G Street, NW., lower level, from 9:00 a.m. to 5:00 p.m. on business days. Send facsimile transmissions to FAX Number (202) 906–7755 or (202) 906–6956 (if the comment is over 25 pages). Send e-mails to public.info@ots.treas.gov and include your name and telephone number. Interested persons may inspect comments at 1700 G Street, NW., from 9:00 a.m. until 4:00 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: Donna Deale, Manager, Supervision Policy, (202) 906–7488; Theresa Stark, Project Manager, Compliance Policy, (202) 906–7054; Paul Robin, Assistant Chief Counsel, (202) 906–6648; Ellen Sazzman, Counsel (Banking and Finance), (202) 906–7133; Koko Ives, Counsel (Banking and Finance), (202) 906–6661, Regulations and Legislation Division, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Goals of the ANPR

Savings associations have long played a major role in providing responsible, affordable home financing. Over the past 25 years, however, the types of loans they have offered—and the competitors they face—have changed considerably. In today's market, mortgage lenders offer potential borrowers a wide variety of options besides the traditional 30-year fixed-rate purchase money mortgage. A secondary market has developed that has narrowed the interest-rate spread on high quality mortgages. Securitization, once available only for high quality fixed-rate mortgages, now funds much of the subprime market. Changes in tax laws have encouraged home equity lending for traditionally unsecured consumer lending purposes.

As the mortgage market has changed over time, so too have OTS's lending regulations, currently codified at 12 CFR part 560. These regulations are based in large part on the assumption that most components of a loan contract should, within the bounds of safety and soundness, be a matter of negotiation between the borrower and the lender. In our experience, that assumption has proven sound for the overwhelming majority of traditional mortgage loans made by savings associations. One of the key issues on which we want public input in this ANPR is whether that assumption holds true for newly developed types of mortgage products—in both the purchase money mortgage and home equity contexts.

We recognize that data about the characteristics of these new products and the markets to which they may be targeted is still being developed. We encourage commenters to share data with us about market trends and the types of loans, lenders, and borrowers involved in various transactions and products. We are particularly interested in data involving high-cost lending and the subprime market, as we believe thrifts are not engaged in significant levels of these activities. Because the

subprime market is growing, we would like to have a thorough understanding of it before thrifts have significant exposure in that market, so our regulations and supervisory strategies address the issues adequately.

Our lending regulations are intended to serve several purposes. As OTS considers whether changes in the lending market should cause the agency to make changes in its regulations, we must balance several goals.

First and foremost, we want our lending regulations to encourage safe and sound lending. Whatever type of mortgage lending or market on which a thrift may focus, the loans it makes must be prudently underwritten. In evaluating mortgage loan applications, institutions must carefully evaluate the capacity of the borrower to make payments on the debt, the level of equity in the property, and the overall credit worthiness of the borrower. The ability of the lender to acquire the borrower?s collateral in order to pay off a loan is no substitute for ensuring that the borrower has the ability to make loan payments in accordance with the terms of the loan contract.

Second, we want to encourage innovation in identifying potential customers and meeting customers' needs. Nontraditional markets may present new opportunities that require novel underwriting approaches but that can still be pursued safely and soundly. Overly detailed regulatory restrictions may quickly prove obsolete as technology advances and potential customers change.

Third, we want to discourage lending practices that prey upon customers' lack of knowledge or options. Such practices may seem like an easy avenue to profitability in the short run, but they are inconsistent with long-term safety and soundness and are contrary to the purposes for which thrifts were created.

Fourth, we want to enable thrifts to compete with other lenders. Except where regulatory restrictions unique to savings associations are statutorily mandated, the agency believes that thrift regulations should be carefully crafted to keep thrifts competitive, consistent with safety and soundness, especially in the area of mortgage lending. Approaches that rely entirely upon OTS's examination, supervision, and enforcement, without addressing OTS regulations that apply both to thrifts and other housing creditors with whom they compete, could have inadvertent negative effects on thrifts' competitiveness without effectively addressing the underlying problems.

Fifth, federal savings associations operate under a uniform system of regulation. Section 5(a) of the Home Owners' Loan Act (HOLA) authorizes OTS "to provide for the organization, incorporation, examination, operation, and regulation" of federal savings associations. 12 U.S.C. 1464(a)(1). Uniformity in regulation, examination, and supervision, regardless of geographic location, is a key component of the federal thrift charter. Federal thrifts know they are subject to one set of federal laws and regulations in all of the key areas of their operations, which enables them to conduct those operations consistently and efficiently.

Finally, but by no means of the least importance, we want to minimize regulatory burden on savings associations. Generally, the market should drive the products offered and terms and conditions in loan contracts should be the result of negotiation between well-informed borrowers and lenders. In some instances, where some level of regulation is required, regulatory burden may be minimized by differentiating among different types of institutions based upon their condition, characteristics, activities, or size.

As we evaluate input on potential approaches to modify our mortgage lending regulations, OTS will be keeping each of these goals in mind. We hope that commenters on this ANPR will provide us with a wide variety of useful insights on how potential changes may further—or impair—any of these goals. While every regulatory change cannot further each of these goals, the agency is particularly interested in hearing from commenters about how any proposed approach that advances one goal might have an inadvertent side effect of impairing another goal.

This ANPR and any subsequent rulemaking affecting OTS's mortgage lending regulations could affect not only federal savings associations, but, through the operation of the Alternative Mortgage Transactions Parity Act ("Parity Act"), may also apply to certain mortgage transactions of state-licensed and regulated housing creditors. As discussed more fully in section II.B below, that statute was enacted to enable those state housing creditors to enter into alternative mortgage transactions, such as variable rate loans, notwithstanding state law, so long as they complied with the regulations on alternative rate mortgage transactions that applied to federally chartered depository institutions. OTS does not have licensing, supervision, examination, or enforcement authority over these housing creditors. Those responsibilities rest with the states, even when the housing creditors choose to provide alternative mortgages under the Parity Act. OTS's statutorily assigned role is solely to designate which OTS lending regulations affecting alternative mortgage transactions are appropriate and applicable to housing creditors when they make such loans under the Parity Act. OTS does not collect information about how many housing creditors choose to take advantage of the Parity Act's preemption of state laws affecting alternative mortgage transactions. Today, as OTS considers whether our mortgage lending regulations continue to meet the purposes for which they were intended, we also solicit comments about how the application of these regulations in the context of the Parity Act may affect housing creditors and their borrowers.

This ANPR first discusses the background of changes and developments in statutes, regulations, and the market that have given rise to questions about how best to encourage responsible, and discourage predatory, lending in the market for alternative mortgages. The ANPR then discusses various regulatory approaches the agency may consider in any rulemaking that may follow this ANPR. Non-regulatory approaches such as education, examination, enforcement of existing statutes and regulations, interagency regulations or supervisory guidance, or industry best practices, may also be appropriate to address some identified issues. The agency is committed to considering all viewpoints presented before determining what approaches to pursue.

II. Background

A. Evolution of OTS's Lending Regulations and the Changing Financial Climate

Mortgage lending—both purchase money mortgages and home equity lending—has always been, and remains, a key area of thrift operations. OTS has periodically conducted comprehensive reviews of its lending and investment regulations to ensure that they enhance safe and sound lending, implement statutory requirements, protect consumers, minimize regulatory burden, and are clearly written and consistent with the regulations of other banking agencies. OTS lending regulations have been considerably modified over time as savings associations, their markets, their competition, and the economy have changed.

Historically, mortgage lending regulations for savings associations were extremely detailed, limiting the loan terms such as permissible length, location of collateral, loan-to-value

ratios, and amortization schedules. Over the last two decades, the regulatory approach of OTS and its predecessor agency, the Federal Home Loan Bank Board (Bank Board), has been to gradually move away from detailed authorization of lending products and specific restrictions on their structure. For the most part, OTS has taken a market-based approach to provide flexibility for thrifts and encourage innovations in lending to stimulate credit. To protect consumers, OTS has required thrifts to disclose terms and conditions to consumers on the assumption that, with this knowledge, the parties would be free to negotiate the lending terms. Ideally such negotiation would result in lenders making competitive safe and sound loans that meet borrowers' needs responsibly—a win-win situation for all involved. One of the reasons OTS is publishing this ANPR, however, is evidence indicating that some provisions in our lending regulations may have a different effect in subprime or high-cost loan markets, where borrowers may not have access to the same information or options, as compared with more traditional markets.

For example, in 1993, as part of a regulatory burden reduction effort, the agency removed a requirement that no institution could impose a prepayment penalty on an ARM borrower within 90 days of a notice of a rate adjustment. This permitted prepayment penalties to be imposed on adjustable rate mortgages under the same conditions as apply for fixed-rate mortgages: prepayments must first be applied to loan principal, but the loan contract governs the terms of any prepayment penalty. In the fixed-rate market, and indeed, in ARMs made by thrifts, prepayment penalties generally have not been abused, and have been a means by which some borrowers can negotiate a lower interest rate on their loans. In the subprime market, however, some studies and news reports indicate that prepayment penalties have been particularly subject to abuse by predatory lenders.[1]

We have been told that some nonfederally chartered housing creditors active in the subprime home equity market often structure their loans as alternative mortgage transactions in order to rely on these federal regulations under the Parity Act, because it gives them more flexibility than state law in charging prepayment penalties and late charges.[2] We solicit comment on the accuracy of these observations and the role the Parity Act plays in today's mortgage markets.

B. The Alternative Mortgage Transactions Parity Act

Congress enacted the Parity Act in 1982, a time of high interest rates, to encourage variable rate mortgages and other creative financing to stimulate credit. In hearings before the Senate in 1981, mortgage bankers testified that statutes in 26 states barred mortgage bankers or state-chartered lending institutions from originating alternative mortgage loans or imposed significantly higher restrictions on such loans than applied to federally chartered lenders operating under federal regulations. Congress wanted to give those state-chartered housing creditors parity with federally chartered institutions by authorizing those creditors to make, purchase and enforce alternative mortgage loans.[3]

The Parity Act applies to loans with any ''alternative'' payment features, such as variable rates, balloon payments, or call features. It allows state licensed housing creditors[4] to engage in ''alternative mortgage transactions'' notwithstanding ''any State constitution, law, or regulation,'' provided the transactions are in conformity with certain federal lending regulations.[5]

The Parity Act does not place state housing creditors under the supervision of federal agencies, but instead merely enables those creditors to make alternative mortgage transactions that comply with designated federal regulations, as an alternative to state law.[6] The Parity Act specifically provides that in order to qualify as a housing creditor and take advantage of the Parity Act's preemption, the creditor must be ''licensed under applicable State law and [remain or become] subject to the applicable regulatory requirements and enforcement mechanisms provided by State law''.[7] Housing creditors, other than state-chartered banks and state-chartered credit unions,[8] that wish to make an alternative mortgage transaction under the authority of the Parity Act must abide by designated OTS regulations.

The Parity Act directed the Bank Board, OTS's predecessor agency, to identify, describe, and publish those portions of its regulations that were inappropriate for, and thus inapplicable to, nonfederally chartered housing creditors.[9] In 1982, the Bank Board published a ''Notice to Housing Creditors'' (1982 Notice) with a request for comments.[10] The 1982 Notice provided that state housing creditors, other than commercial banks, credit unions or federal associations, may make alternative mortgage loans subject to the Bank Board's requirements on adjustments to rate, payment, balance or term of maturity and disclosure. The agency premised this approach on the statement of Congressional intent that Title VIII ''does not place state housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law.''[11] The 1982 Notice identified as appropriate and applicable those regulations that ''describe and define'' alternative mortgage transactions and not those regulations intended for the

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[1] Prepayment penalties arise in the case of subprime lending with much greater frequency than in the conventional market. Rich Connell, ''Safeguards Sought for Inner City Borrowers,'' Los Angeles Times, March 12, 2000, at B6. For example, in 1998 Merrill Lynch estimated that 50–75% of home equity loans (primarily subprime) that they securitized included some kind of prepayment penalty. ''Lenders Test Whether Mortgage Prepayment Penalties Insulate Against Portfolio Runoff,'' Inside Mortgage Finance, January 16, 1998. In contrast, in the case of home loan purchases by Fannie Mae, the overwhelming majority of which are conventional, less than 2% carry prepayment penalties. ''Fannie Revamps Prepayment Penalty Bonds,'' American Banker, July 20, 1999.

[2] For example, the National Home Equity Mortgage Association (NHEMA), the largest national trade association focusing primarily on the home equity lending market, sued to enjoin Virginia from enforcing its statutes limiting prepayment penalties for alternative mortgage transactions. NHEMA's members include mortgage lending corporations and secured equity lenders. The federal district court found that the Virginia statutes were preempted by the Parity Act and that NHEMA had standing to bring the suit. ''NHEMA's members are state housing creditors subject to the Parity Act who are suffering or will suffer injury from the enforcement of penalties announced by the state.'' *National Home Equity Mortgage Association* v. *Face,* 64 F. Supp. 2d 584, 591 (E.D. Va. 1999), appeal docketed, No. 99–2331 (4th Cir. Oct. 21, 1999).

[3] 12 U.S.C.A. 3801(b) (West 1989). *See also NHEMA* v. *Face,* 64 F. Supp. 2d at 587.

[4] A ''housing creditor'' is a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, ''any person who regularly makes loans, credit sales or advances secured by interests in properties referred to in [the Parity Act]; or * * * any transferee of any of them.'' 12 U.S.C.A. 3802(2).

[5] *Id.;* 12 U.S.C.A. 3803 (West 1989).

[6] OTS Op Chief Counsel (May 3, 1996) at 8, fn. 16 citing Report of the Committee on Banking, Housing, and Urban Affairs, Senate Report No. 97–463 at p. 55 (May 28, 1982), 97th Cong., 2d Sess. 55 and 48 FR 23,032, 23,053 (May 1983).

[7] 12 U.S.C. 3802(2).

[8] 12 U.S.C.A. 3803(a) (West 1989). State-chartered banks and state-chartered credit unions must comply respectively with regulations of the Office of the Comptroller of the Currency and the National Credit Union Administration.

[9] Section 807 of Pub. L. 97–320 (1982).

[10] 47 FR 51733 (November 17, 1982).

[11] U.S. Senate Report No. 97–463 at p. 55 (May 28, 1982), 97th Cong., 2d Sess. 55 and 48 FR 23032, 23053 (May 23, 1983).

general supervision of federal associations.

In 1983, the Bank Board published a final rule incorporating a revised Notice to Housing Creditors (1983 Notice). The 1983 Notice identified as applicable three provisions that the Bank Board described as an integral part of, and particular to, alternative mortgage transactions, namely § 545.33(c) (authority to make partially amortized or non-amortized loans and to adjust the interest rate payment, balance or term of maturity); (e) (limitations on adjustments on loans secured by borrower-occupied property); and (f)(4)–(11) (requirements for disclosures on loans secured by borrower-occupied property that are not fixed-rated and fully amortized).[12]

In 1996, after reexamining the purposes of the Parity Act, OTS reevaluated which regulations should be deemed appropriate and applicable to alternative mortgage transactions. OTS concluded that variable rate loans made by Wisconsin-chartered savings and loan associations in conformity with the Parity Act are not subject to a Wisconsin statute restricting prepayment penalties on variable rate loans.[13] The opinion stated that because OTS regulations permitted federal thrifts, through terms in their loan contracts, to impose prepayment penalties on variable rate loans (as well as other loans), state housing creditors lending under the Parity Act could impose those penalties. Otherwise state housing creditors would be disadvantaged vis-a-vis federal thrifts—the very result Congress intended to prevent. Using this analysis, the agency did not limit potentially appropriate and applicable regulations for state housing creditors to those regulations applying only to alternative mortgage transactions and not other mortgage loans.

Later that year, OTS modified its Parity Act regulations, now codified at 12 CFR 560.220.[14] The list of OTS regulations applicable to state housing creditors now includes regulations on late charges (§ 560.33), prepayments (§ 560.34), adjustments to home loans (§ 560.35), and disclosure (§ 560.210).[15] Housing creditors must comply with the requirements contained in these regulations in order to obtain the benefit of the Parity Act's preemption of state laws.

C. Subprime Lending and Potentially Predatory Practices

The flow of responsibly delivered credit to underserved markets is critical to their survival. Thrifts and other lenders that provide credit and other financial services in ways that actually reach and fairly serve underserved borrowers fill an important community need. OTS believes it is important for thrifts to reach out to underserved markets and to make safe and sound loans—both prime and subprime—in such markets.

The 1990's have seen an explosive growth in subprime lending: *i.e.*, extending credit to borrowers whose past credit problems make them a higher risk. Subprime lenders use risk-based pricing to serve borrowers with troubled credit histories who cannot obtain credit in the prime market. Subprime loans pose higher risks to an institution and require a lender to have or develop particularized loan underwriting and management skills.[16] The higher degree of risk associated with subprime borrowers often necessitates a higher cost or other non-traditional terms for a subprime loan.

Subprime lending helps provide borrowers with a bridge to conventional financing once the borrower resolves temporary credit problems. However, subprime lending can become predatory if it makes it difficult for borrowers to get out of debt once their credit improves. Unfortunately, some segments of the subprime lending market use unscrupulous practices, more fully described below, to pressure a borrower into a commitment for a high-cost loan. It is important that our mortgage lending regulations actively discourage, rather than inadvertently allow, predatory practices by those who rely upon our regulations—whether they be thrifts, their subsidiaries or affiliates, or non-depository institution housing creditors relying upon the Parity Act.

Predatory practices that unfairly disadvantage borrowers can take a variety of forms. For example, an unscrupulous lender may use pressure tactics to convince the borrower to consolidate mortgage and consumer debt into a loan that is in fact less advantageous to the borrower; refinance a low interest rate mortgage loan to one with higher rates and fees but a longer term that lowers the borrower's current mortgage costs while vastly increasing the total cost of financing; undertake unnecessarily expensive home improvements; or finance unnecessary fees for products like credit insurance.[17]

Predatory lenders may also include loan terms in mortgage documents that make it difficult for the borrower to pay off the loan. Some examples of such loan terms include negative amortization repayment terms where monthly payments fail to pay off accrued interest and increase the principal loan balance; high balloon payments at the end of the loan; high loan-to-value (LTV) loans that lock the borrower into additional debt; mandatory arbitration partially paid for by the borrower; and high prepayment penalties that prevent borrowers from refinancing or selling their home. While these terms may be reasonable when fully understood by a sophisticated borrower with the ability and motivation to shop for a loan, they can be grossly unfair when misunderstood by an unsophisticated borrower pressured into accepting them.

D. Interagency Implications

OTS recognizes that its regulations can only go so far to address predatory practices. Some practices may raise issues involving the Truth in Lending Act, the Home Ownership and Equity Protection Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, and other statutes and regulations generally affecting depository institutions or creditors. These laws are implemented through regulations imposed by agencies other than OTS, including the Federal Reserve Board and the Department of Housing and Urban Development. Like other insured depository institutions, thrifts are subject to regular examination and supervision for their compliance with this comprehensive federal network of

[12] 48 FR 23032, 23053 (May 23, 1983).

[13] OTS Op. Chief Counsel (April 30, 1996).

[14] As a federal court recently recognized, OTS may revise, on a continuing basis, the list of provisions that apply to housing creditors lending under the authority of the Parity Act. The Parity Act ''implies no temporal limit on [OTS] rulemaking as it applies to state chartered housing creditors.'' *NHEMA* v. *Face*, 64 F. Supp. 2d at 589. As the court noted, the legislative history of the Parity Act shows that Congress contemplated future revisions to federal agency regulations and expected conforming agency actions so that the regulatory list would continue to provide parity to state housing creditors. *Id.,* quoting S. Rep. 97–463, at 55 (1982)(Congressional expectation that ''any future amendments that the agencies make to regulations that are within the scope of this title will conform to the objectives of this title.'')

[15] 12 CFR 560.220 (1999).

[16] On March 1, 1999, the four federal banking agencies—OTS, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency—issued ''Interagency Guidance on Subprime Lending.'' That guidance discussed a variety of controls that an insured depository institution engaging in subprime lending should have in place to ensure that it is properly controlling the risks the activity can present.

[17] For example, a recent New York Times/ABC News article reported examples of a variety of such practices. ''Profiting From Fine Print With Wall Street's Help,'' New York Times (March 15, 2000).

laws and their implementing regulations. Most non-depository institution creditors may be equally subject to such laws, but their regulators do not use the same examination and supervision process to regularly monitor their compliance. OTS will share with other regulators any issues that commenters raise that implicate any of these statutes or their implementing regulations.

OTS participates in a number of interagency efforts to address responsible subprime lending and limit predatory practices. An interagency working group has been established to examine predatory lending issues. This group, which includes the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Department of Justice, the Federal Trade Commission, the Department of Housing and Urban Development, the Federal Housing Finance Board, and the Office of Federal Housing Enterprise Oversight, is considering a variety of policy, regulatory, and legislative options as well as consumer education initiatives.

E. State Initiatives to Address Predatory Lending

OTS is aware that several states have undertaken statutory or regulatory initiatives to protect their citizens from some of the abuses of predatory lending. OTS believes that such initiatives are worth studying as it considers the scope and direction of any potential regulatory actions. We are interested in learning more about these initiatives and other states' proposed statutory or regulatory initiatives in these areas. Commenters are therefore urged to address the advantages and disadvantages of these initiatives, especially in connection with state-regulated housing creditors.

North Carolina, for example, has recently enacted legislation that addresses predatory lending and covers all consumer home loans including first and junior liens and manufactured housing. The legislation limits prepayment penalties, financing credit insurance, flipping (repeated unjustified refinancing of loans), and default incentives. The act also establishes a class of ''high-cost home loans'' (*e.g.,* loans with total points and fees in excess of 5–8% of the loan amount or an annual percentage rate more than 10 percentage points higher than the yield on Treasury securities of comparable maturities). The act applies additional consumer protections to these high-cost loans including required consumer counseling, prohibitions on financing fees and points in the loans, and other safeguards. Violations of the act may result in a determination that the loan is usurious or that an unfair trade practice has occurred. Additionally, the borrower may be permitted to recover attorney's fees.

New York has proposed regulations to impose certain limitations on the making of high-cost home loans to consumers. The proposed regulations define high-cost home loans as loans that are made either at a rate exceeding eight percentage points over U.S. Treasury securities of comparable maturities or, in the case of junior mortgages, nine percentage points above such securities. High-cost home loans also include any mortgage loan with total points and fees (other than bona fide discount points) exceeding five percent of the principal amount of the loan. The proposed regulations prohibit high-cost home loans from including terms such as balloon payments within seven years of origination, negative amortization, elevated rates of interest after default, certain mandatory arbitration clauses, modification or deferral fees, and accelerated payment schedules at the discretion of the lender. The proposed regulations also prohibit high-cost home lending without a disclosure at the time of application concerning home ownership counseling and without due regard to the obligor's ability to repay the loan.

F. Other Regulatory Incentives to Encourage Responsible Lending

OTS invites public comment on potential federal regulatory incentives to encourage financial institutions to seek out responsible ways to meet the lending and other financial services needs of underserved borrowers consistent with safety and soundness. We are interested in innovative approaches to facilitate responsible lending in underserved markets—whether prime or subprime—and to limit predatory practices that subject borrowers to improper pressures, unduly limited options, and unnecessary costs.

III. Potential Regulatory Approaches

This ANPR solicits public input from any interested parties, including savings associations, consumers, housing creditors, and state and local regulators, on a wide variety of potential regulatory approaches that would encourage responsible lending and discourage predatory practices. OTS is particularly interested in learning from the states' experience with recent statutory and regulatory actions dealing with subprime lending and predatory lending practices, such as the North Carolina statute and New York proposed regulation discussed above.

The approaches discussed below focus on mortgage lending, with an emphasis on the high-cost loan arena that has proven particularly vulnerable to potential abuses. We would like input about other potential approaches, consistent with OTS's overall goals for its lending regulations, to address these issues. We recognize that changes in regulations may not ultimately turn out to be the best way to address some of these issues. In some cases supervisory guidance or industry best practices may be more effective and less burdensome.

We encourage commenters to identify potential regulatory or paperwork burdens that some approaches might impose and ways to minimize such burdens. We are also interested in identifying approaches that might impose a disproportionate burden upon small savings associations and alternatives that might minimize such burdens.

Should OTS Modify Its Regulations Implementing the Alternative Mortgage Transactions Parity Act?

As discussed above, the Bank Board and OTS have identified various regulations over time as appropriate and applicable to alternative mortgage transactions under the Parity Act. We solicit comment on whether all of the regulations that are currently designated as appropriate and applicable should continue to be so designated. Should only those OTS regulations that apply exclusively to alternative mortgage transactions be designated appropriate and applicable (the approach taken by the Bank Board in 1982)? Should every regulation that imposes conditions or restrictions on a federal savings association's ability to make an alternative mortgage transaction be designated appropriate and applicable, even if the regulation applies to a broader category of loans (the approach taken by OTS in 1996)? Is another standard appropriate?

The Parity Act, as discussed above, authorizes housing creditors to make alternative mortgage loans as long as the transactions are ''in accordance with'' appropriate and applicable OTS regulations. The Act does not grant housing creditors the same powers as federal savings associations outside of the context of alternative mortgage transactions. Even within that context, state law governs those aspects of a housing creditor's operations not covered by regulations designated as applicable to alternative mortgage transactions under the Parity Act. The limited role the Parity Act plays in the

overall regulation of housing creditors has not always been clearly understood. OTS solicits comments on how best to clarify the interaction between federal and state regulatory schemes affecting housing creditors. OTS is also interested in information about how state laws and regulations on alternative mortgage transactions have changed since the Parity Act was enacted in 1982.

If commenters believe OTS should revise the scope of applicable regulations designated under the Parity Act, we are interested in recommendations about what factors and standards the agency should consider in determining appropriate and applicable regulations. The agency has a continuing responsibility to implement congressional intent as expressed in the 1982 Parity Act consistent with the realities of the current market in which federal savings associations and state housing creditors make alternative mortgage transactions. Therefore, we also are interested in whether additional regulations, including any that may result from a rulemaking following this ANPR, should be added to the list of appropriate regulations.

In determining appropriate and applicable regulations, OTS must keep the overall congressional goal of parity in mind.[18] Like other insured depository institutions, savings associations are subject to a comprehensive regime of regular examination, supervision, and enforcement to determine their compliance with applicable laws and regulations. Non-depository institution state housing creditors are not. How should these significant differences in examination, supervision and enforcement be taken into account so that alternative mortgage transactions by non-depository institution state housing creditors under the Parity Act are treated neither more harshly nor more leniently than similar transactions by savings associations?

In considering whether to alter the operation of OTS lending regulations with respect to institutions benefiting from the Parity Act, we wish to act on an informed basis. OTS is interested in receiving evidence of the extent to which housing creditors taking advantage of the Parity Act are engaged in predatory or abusive lending practices. We recognize that the actions of a few entities do not necessarily represent an entire industry. While a number of press reports have recounted instances of egregious practices in connection with mortgage credit, the degree of participation in such practices by housing creditors that have used the Parity Act and OTS's implementing regulations to avoid state law restrictions has not been studied in any focused manner. Accordingly, we raise the following questions:

• To what extent are housing creditors engaging in predatory or abusive mortgage lending practices that would be contrary to existing state law but for the provisions of the Parity Act and OTS's implementation thereof?

• To what extent are housing creditors engaging in predatory or abusive mortgage lending practices that are contrary to existing laws, but are not being prosecuted by state authorities whose power is specifically reserved by the Parity Act for that purpose?

As previously noted, OTS has curtailed its lending regulations to permit savings associations to respond more efficiently to competitive market forces. Some have argued that the ability of housing creditors to rely on these limited regulations through the Parity Act may have resulted in abuses in markets where there are fewer competitive pressures and no regular governmental oversight. To explore this possibility, we solicit comment on the following questions:

• To what extent do housing creditors lending under the Parity Act use different practices and impose more onerous loan terms in under-served or financially unsophisticated markets than they (or their affiliates) use in other more mainstream markets?

• To what extent do housing creditors lending under the Parity Act provide mortgage credit at rates and with terms significantly above those of conventional prime mortgages to persons with good or excellent credit records?

• To what extent does the use or terms of prepayment penalties, the financing of prepaid credit life insurance or loan fees, or the frequency of partial amortizing, non-amortizing or negative amortizing loans vary among housing creditors or between housing creditors and insured depository institutions? Do variations relate to characteristics of the borrower (such as race or age) or the neighborhood in which the borrower resides or to quantifiable differences in the creditworthiness of the borrower? Do variations result in returns that compensate lenders in excess of risk-adjusted prices or loan terms?

• Do housing creditors refinance their own (or an affiliate's) borrowers' mortgage loans (including the financing of loan fees) at rates at or above those on the existing loan? Does this practice exist at insured depository institutions?

• How, if at all, do the answers to any of the above questions differ for housing creditors who do not make alternative mortgage transactions under the Parity Act but rely instead upon state law?

Should OTS Adopt Regulations on High-Cost Mortgage Loans?

The explosive growth in subprime lending has occurred, and many of the predatory practices in the mortgage market discussed above have developed, since OTS last modified its lending regulations. Where borrowers are less knowledgeable or more in need of credit than has been the case in the past, a market-based approach to regulation that relies on disclosures to equalize the negotiation postures of the lender and borrower may not be effective. As a result, some states have gone beyond the loans covered and disclosures required by the Home Ownership and Equity Protection Act of 1994, Pub. L. 103–325, Title I, Subtitle B (Sept. 23, 1994) (HOEPA), to impose more substantive restrictions and limitations to protect such borrowers. OTS could similarly choose to enact regulations that would apply to high-cost loans originated by some or all savings associations. Depending on the scope of the OTS's Parity Act regulations and whether a state with its own statutes or regulations on high-cost loans had opted out from the Parity Act, these regulations could also apply to high-cost loans made by state housing creditors, as such loans are nearly always structured as alternative mortgage transactions.[19] Such regulations would raise a variety of issues, including:

What loans should be covered? HOEPA applies to certain mortgages where either the annual percentage rate at consummation of the transaction exceeds by more than 10 percentage points the yield on Treasury securities of comparable maturities or the total points or fees the borrower must pay exceed the greater of 8% of the loan amount or $400 (as adjusted annually based on changes in the Consumer Price Index). The North Carolina and New York provisions discussed above apply to a broader range of loans, but similarly use the annual percentage rate and the ratio of total points and fees to loan amount to define the scope of loans covered. Some criteria differ depending on whether senior or junior mortgage liens were involved. What are the advantages or disadvantages of these approaches? Are there other factors that

[18] See discussion in footnote 14, *supra*.

[19] Of course, Parity Act lenders could, if their home state regulations were more lenient than revised OTS regulations, simply follow state law rather than the OTS regulations.

should be considered in defining high-cost loans? How should high-cost loans be defined to reach areas where the potential for abuse is highest without having an unnecessarily chilling effect on non-traditional, but non-abusive, loan structures?

Should OTS impose limits on financing of certain fees or charges? Predatory loans are often dependent on the financing of points and fees in the loan, including charges to third parties. Financing these fees may hide their magnitude and impact from the borrower and enable unethical lenders to pile on unwarranted fees. Should OTS, in connection with high-cost loans, limit an institution's ability to finance fees and points above a certain amount, credit life insurance, and/or brokerage commissions?

Are limits on refinancing appropriate? Should any OTS regulation on high-cost loans limit rollovers and refinancings on such loans within a specified time frame or where a refinancing would actually increase the cost of funds previously loaned? Should we limit or prohibit refinancing an institution's own (or an affiliate's) mortgage unless the annual percentage rate for the new loan is less than the rate reflected on the existing note and no fees are financed?

Are prepayment penalties appropriate for high-cost loans? Do high-cost loans present such potential for the abusive use of prepayment penalties that OTS should limit such penalties on such loans, either with respect to amount or when they can be imposed (*e.g.,* not within a certain number of days after a change in interest rate)? Should prepayment penalty terms in such loans be prohibited except where initial mortgage rates are set at less than market rate?

What limits on balloon payments, negative amortization, post-default interest rates and mandatory arbitration clauses would be appropriate for high-cost loans? Should OTS limit the inclusion of such terms as balloon payments (at least prior to seven years), negative amortization, higher interest penalties after default, and mandatory arbitration clauses for high-cost loans?

Should OTS require lenders to determine the suitability of a mortgage loan product for a particular borrower? As discussed above, an important component of safe and sound lending is determining the borrower's ability to repay the loan. Should OTS require institutions to document the suitability of a particular high-cost loan product for a particular customer/borrower, including an analysis of the customer's ability to repay the loan without relying on the collateral? This approach would be similar to the ''sophisticated investor'' or suitability analysis standard used in the securities industry in determining whether a particular investment product should be sold to a potential investor. Suitability standards as applied to the residential mortgage industry might include a relatively straight-forward analysis of factors such as comparing projected monthly payments against the applicant's income or determining the propriety of add-on features that the consumer may not need, such as credit life insurance where the individual does not have any dependents. If ''suitability'' is not established, then the institution would be subject to additional limits and higher requirements in making a loan. Such standards could impose regulatory burdens on thrifts if they required thrifts to go beyond the factors normally considered in underwriting a loan. Would such a burden be outweighed by the benefits of the potential deterrent effect of such a requirement?

Should OTS require institutions to notify applicants for high cost loans of the availability of home loan counseling programs before closing? For borrowers that do not fully understand the credit process and the choices available to them, a disclosure of the availability of counseling programs may prompt them to more fully explore their options before closing on a high cost loan. The New York provisions, for example, prohibit the making of a high cost loan without first notifying applicants that they should consider counseling and providing them with a list of approved counselors. Should OTS consider imposing some similar type of requirement for institutions that provide high cost loans? How could such a list be generated and by whom? How could we minimize any associated paperwork burden?

Is Differential Regulation Appropriate?

For the past decade, OTS has differentiated among thrifts in determining whether they must file a notice or application with the agency before engaging in certain activities. This differentiation looks at, among other things, a thrift's capital, safety and soundness rating, and compliance ratings. *See* 12 CFR part 516. Such differentiation may be appropriate in the context of subprime or high-cost loan programs. As discussed in the interagency guidance on subprime lending cited above, subprime and high-cost lending can pose potential safety and soundness risks. Before an institution with a lower safety and soundness or compliance rating undertakes a significant level of subprime or high-cost lending, it may be appropriate for the agency to review that thrift's management and internal controls. Thrifts with stronger ratings and management that are eligible for expedited treatment could be subject to different, less onerous restrictions.

If OTS were to take the examination ratings, among other characteristics, of federal savings associations making certain types of alternative mortgage loans, into account in determining whether the agency should receive advance notice of certain lending activities, how could a differential approach apply to housing creditors making similar loans? State-regulated housing creditors are not subject to the same level of regular comprehensive examination as federally insured depository institutions. They are unlikely to have capital, safety and soundness, or compliance ratings. Under these circumstances, enabling such housing creditors to offer certain alternative mortgage loans in parity with federal savings associations—under neither harsher nor more lenient conditions—will require careful agency consideration. Thus, if OTS were to require some federal savings associations to notify OTS before making alternative mortgage transactions as part of a high-cost loan program, how would a comparable requirement be implemented for housing creditors? How, if at all, do states differentiate among the conditions and characteristics of housing creditors they license and regulate?

The Parity Act contemplates situations where a housing creditor may not be able to comply with the letter of an applicable OTS regulation in making an alternative mortgage transaction. In such circumstances, the Parity Act considers the alternative mortgage transaction to be in accordance with the regulation if the transaction is in ''substantial compliance'' with the regulation and any error is corrected within 60 days.[20] OTS solicits comments from housing creditors and their state regulators about how to determine ''substantial compliance'' with OTS regulations using different standards for federal savings associations in different conditions. We seek input from housing creditors and their state regulators about any other practical implications of a differential regulatory approach.

[20] 12 U.S.C. 3803(b).

How Should OTS Deal With Potential Lending Issues Raised by Thrift Subsidiaries or Affiliates?

Some believe that subsidiaries and affiliates of insured depository institutions engage in lending practices that may disadvantage potentially vulnerable customers. OTS is interested in any evidence on this issue. Subsidiaries of savings associations are subject to OTS examination and supervision. If, however, they pose different or higher risks than their parent thrifts in this area, OTS could consider modifying its subordinate organizations regulations, 12 CFR Part 559, to address these risks. Should OTS impose limits on subsidiaries engaged in a significant amount of subprime lending on behalf of their parent federal thrifts? Should OTS restrict institutions' efforts to steer customers who are labeled high risk to one particular organizational unit of a thrift? Should thrifts and their subsidiaries that offer a variety of loans be required to inform customers of all available lending alternatives regardless of the location at which the customer initially seeks assistance? Should OTS consider restricting a thrift's interactions with affiliates that engage primarily in subprime lending? Would any such limits or restrictions affect a thrift's ability to develop expertise in different components of its organization or its ability to manage the risks associated with different types of lending?

Should OTS Impose Certain Due Diligence Requirements?

It has been argued that the secondary market has had a disproportionate impact in facilitating some potentially predatory practices in the high-cost loan market.[21] In addition to their role in originating mortgage loans, thrifts form an important part of the secondary market through their purchase of whole loans or investments in mortgage-backed securities. Given that the secondary market both plays a role in the high-cost loan market and is a vital part of housing credit liquidity, potential solutions to some of the problems in the high-cost mortgage loan market may be found in the secondary market. Accordingly, should OTS require federal thrifts to conduct a due diligence review of potential loan purchases to determine whether the loans meet applicable federal or state rules relating to predatory practices? For example, an institution might sample loan files to ensure that the originating lender has appropriately priced the product, looking for evidence of excessive fees. This review may be merely an adjunct to any other due diligence analysis that prudent institutions would undertake to ensure that purchased loans are properly secured and have been authenticated. How could any burden of such a requirement be minimized consistent with achieving the goal of ensuring that purchased loans meet applicable laws and regulations?

Similarly, should OTS encourage thrifts to inquire whether securitizers from whom they purchase interests in loan pools have conducted their own due diligence efforts with regard to the underlying loans? The institution could, for example, make inquiries to the securitizers concerning their efforts to minimize the inclusion of predatory loans in their securitized pools. Would the concerted efforts by institutions to conduct such inquiries help to deter predatory practices?

We are also interested in understanding the extent of due diligence conducted by secondary market mortgage investors to determine whether housing creditors benefiting from the Parity Act comply with applicable federal consumer protection and fair lending laws. Does due diligence vary depending on whether the selling institution is an insured depository institution undergoing regular federal compliance examinations or an unsupervised housing creditor?

IV. Conclusion and Request for Comments

The flow of responsibly delivered credit to underserved markets is critical to their survival, and any regulatory or enforcement solutions that might be crafted to deal with predatory lenders must proceed with this caution in mind. With this ANPR, OTS seeks input from all interested parties to assist in determining how best to address some of the issues that have arisen in the alternative mortgage market. OTS is interested in hearing from any and all potentially affected persons, including representatives of the thrift industry, housing creditors, consumers, and state governments. Hearing from commenters with diverse viewpoints will help the agency to develop strategies to identify the lending risks and opportunities in underserved communities and to help thrifts develop and institute responsible lending programs in low-income and minority communities. We are interested in data that will help identify where problems exist and whether and how OTS regulations could be modified to help address those problems. We encourage commenters to suggest other approaches not discussed above that could meet our overall goal of encouraging the safe and sound, efficient delivery of low-cost credit to the public free from undue regulatory duplication and burden.

Dated: March 24, 2000.

By the Office of Thrift Supervision.

Ellen Seidman,

Director.

[FR Doc. 00–8375 Filed 4–4–00; 8:45 am]

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[21] See, for example, the New York Times/ABC News article cited in footnote 17, *supra.*

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 99–NM–333–AD]

RIN 2120–AA64

Airworthiness Directives; McDonnell Douglas Model DC–9–10, –20, –30, –40, and –50 Series Airplanes, and C–9 (Military) Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes the supersedure of an existing airworthiness directive (AD), applicable to certain McDonnell Douglas Model DC–9–10, –20, –30, –40, and –50 series airplanes and C–9 (military) airplanes, that currently requires a one-time visual inspection to determine if the doorstops and corners of the doorjamb of the forward passenger door have been modified, various follow-on repetitive inspections, and modification, if necessary. This action would require a reduction in the inspection threshold and repetitive intervals for a certain doubler configuration and an increase in the repetitive inspection interval for a certain other doubler configuration. This proposal is prompted by a determination that certain inspection compliance times were incorrect. The actions specified by the proposed AD are intended to detect and correct fatigue cracking, which could result in rapid decompression of the fuselage and consequent reduced structural integrity of the airplane.

DATES: Comments must be received by May 22, 2000.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 99–NM–