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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 567

[No. 2001-14]

RIN 1550-AB45

Capital: Qualifying Mortgage Loan, Interest Rate Risk Component, and Miscellaneous Changes

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of Thrift Supervision (OTS) is soliciting comment on a number of proposed changes to its capital regulations. These changes are designed to eliminate unnecessary capital burdens and to align OTS capital regulations more closely to those of the other banking regulators. Under the proposed rule, a one-to four-family residential first mortgage loan may qualify for a 50 percent risk weight if it meets certain criteria, including a loan-to-value (LTV) ratio below 90 percent. Currently these loans must have an LTV ratio of 80 percent or less to qualify for the 50 percent risk weight. OTS also proposes to: eliminate the requirement that a thrift must deduct from total capital that portion of a land loan or a nonresidential construction loan in excess of an 80 percent LTV ratio; eliminate the interest rate risk component of the risk-based capital regulations; increase the risk weight for high quality, stripped mortgage-related

securities from 20 percent to 100 percent; modify the definition of OECD-based country; and make a technical change to conform its treatment of reserves for loan and lease losses to that of the other banking agencies.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES:

Mail: 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. 2001-14.

Delivery: Hand deliver comments to the Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9:00 a.m. to 4:00 p.m. on business days, Attention Docket No. 2001-14.

Facsimiles: Send facsimile transmissions to FAX Number (202) 906-7755, Attention Docket No. 2001-14; or (202) 906-6956 (if comments are over 25 pages).

E-Mail: Send e-mails to "public.info@ots.treas.gov," Attention Docket No. 2001-14, and include your name and telephone number.

Public Inspection: Interested persons may inspect comments at the Public Reference Room, 1700 G St. N.W., from 10:00 a.m. until 4:00 p.m. on Tuesdays and Thursdays or obtain comments and/or an index of comments by facsimile by telephoning the Public Reference Room at (202) 906-5900 from 9:00 a.m. until 5:00 on business days. Comments and the related index will also be posted on the OTS Internet Site at "www.ots.treas.gov."

FOR FURTHER INFORMATION CONTACT: Michael D. Solomon, Senior Program Manager for Capital Policy (202/906-5654); David Riley, Project Manager (202) 906-6669, Supervision Policy; or Teresa Scott, Counsel (Banking and Finance) (202) 906-6478, Regulations and Legislation Division, Office of the Chief Counsel, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

OTS is soliciting comment on a number of proposed changes to its capital regulations. These changes are designed to eliminate unnecessary capital burdens and to align OTS capital regulations more closely to those of the other banking regulators.

II. Discussion of Proposed Changes

A. One- to Four-Family Residential Mortgage Loan

OTS, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC) (the Banking Agencies) apply similar, but not identical, capital rules to one- to four-family residential first mortgage loans. Each agency provides that a one- to four-family residential first mortgage loan may receive a 50 percent risk weight if the loan meets certain specified criteria. To be eligible to receive the 50 percent risk weight, each agency requires that the loan may not be more

than 90 days delinquent and must be prudently underwritten.[1]

Only OTS rules specifically require that a one- to four-family residential loan must have a loan to value (LTV) ratio of 80 percent or less at origination in order to qualify for the 50 percent risk weight.[2] All of the Banking Agencies, however, have indicated that prudent underwriting must include an appropriate LTV ratio,[3] and have clarified that a loan secured by a one- to four-family residential property will have an appropriate LTV ratio if the loan complies with the Interagency Guidelines for Real Estate Lending (Interagency Lending Guidelines).[4] While the Interagency Lending Guidelines do not establish a specific supervisory LTV limit for a one- to four-family residential property, the guidelines state that an institution should require appropriate credit enhancements (e.g., mortgage insurance) for a loan with an LTV that equals or exceeds 90 percent at origination.

In today's rulemaking, OTS is proposing to revise its definition of qualifying mortgage loan to permit loans with LTV ratios below 90 percent to qualify for the 50 percent risk weight. OTS believes that the 80 percent or less LTV requirement may no longer be appropriate for the reasons stated below.

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[1] 12 CFR part 3, App. A., Sec. 3(a)(3)(iii)(OCC): 12 CFR part 208, App. A., Sec. III. C.3.(FRB); 12 CFR part 325, App. A., Sec. II.C. (FDIC); 12 CFR 567.1 (OTS).

[2] See definition of qualifying mortgage loans at § 567.1.

[3] 64 FR 10194, 10196, fn. 6 (Mar. 2, 1999).

[4] Id. The Interagency Guidelines for Real Estate Lending are located at 12 CFR part 34, subpart D (OCC); 12 CFR part 208, subpart E (FRB); 12 CFR part 365 (FDIC); and 12 CFR 560.100-101 (OTS).

First, this change would conform OTS capital requirements more closely to the rules and guidance of the other Banking Agencies as directed by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRIA).[5] That section requires OTS and the Banking Agencies to make their regulations and guidance uniform, consistent with the principles of safety and soundness, statutory law and policy, and the public interest. This proposed change would also make the capital rules more consistent with interagency supervisory guidance on high LTV loans. In the Interagency Guidance on High Loan-to-Value Residential Real Estate Lending issued October 13, 1999 (Interagency LTV Guidance),[6] the Banking Agencies defined a high LTV loan as an extension of credit secured by liens or interests in an owner-occupied, one- to four-family residential property that equals or exceeds 90 percent of the real estate's appraised value, unless the loan has appropriate credit support.

Unlike the other Banking Agencies, however, OTS proposes to continue to include an express LTV requirement in the definition of qualifying mortgage loan. The LTV ratio has played, and will continue to play, an important role in determining mortgage loan risk. Because thrifts have a greater concentration in home mortgage lending, OTS believes that greater regulatory clarity is helpful.

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[5] 12 U.S.C. 4803(a).

[6] OTS Thrift Bulletin 72a.

Second, OTS research suggests that one- to four-family residential loans are generally subject to a disproportionately high capital burden, relative to other types of loans.[7] OTS's review of charge-off and delinquency rates[8] for various categories of loans (one- to four-family residential loans, multi-family loans, other real estate loans, consumer loans, agricultural loans, commercial and industrial loans) disclosed that one- to four-family residential loans carry substantially less risk than other loan types, relative to their respective risk weights. Based on this research, OTS believes it may prudently expand the class of one- to four-family residential mortgages that qualify for the 50 percent risk weight.[9] By including loans with LTV ratios below 90 percent within the definition of qualifying mortgage loan, OTS would reduce the disparity of the risk weights among these loans and expand the availability of residential mortgage products.

In addition to the revised LTV criterion, OTS is proposing a clarifying change to its definition of qualifying mortgage loan. Under the current rule, a qualifying mortgage loan must have a documented LTV ratio not exceeding 80 percent at origination. The proposed rule would clarify that mortgage loans that did not meet the LTV ratio at origination but are subsequently

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[7] See OTS Research Working Paper titled, "Basel Buckets and Loan Losses: Absolute and Relative Loan Underperformance at Banks and Thrifts," available on the OTS website at www.ots.treas.gov.

[8] The charge off rate is charge offs net of recoveries for each loan type divided by the total loan balance of that type of loan. The delinquency rate is the sum of loans more than 90 days past due for each loan type, divided by the total loan balance for that type of loan. Our review of charge-off data, which co-mingled expected and unexpected losses, covered the period from 1984 to 1999. While risk-based capital is primarily for unexpected losses, average (historical) losses are not irrelevant. For example, capital levels can be modeled based on dispersion of expected (historical) losses.

[9] In the past, some institutions have over-invested in fixed-rate one- to four-family mortgage loans, which created interest rate risk problems. However, as discussed below, improved supervisory tools for interest rate risk analysis, industry awareness of interest rate risk, and improved interest rate risk management have mitigated this concern.

paid down to the appropriate LTV ratio may become qualifying mortgage loans, if they meet all other requirements.

OTS solicits comment on all aspects of the proposed definition of qualifying mortgage loan. Specifically, OTS asks commenters to address the following questions:

- *Is the revised LTV standard appropriate? Under the proposed rule, a mortgage loan with an LTV that is precisely 90 percent would not be a qualifying mortgage loan. Is this treatment appropriate?*
- *Should OTS delete the explicit LTV standard from the definition?*
- *Should OTS impose a standard other than the LTV ratio to determine whether a mortgage loan should be accorded a 50 percent risk weight?*
- *Under the current capital rule, a mortgage loan may satisfy the LTV requirement if an issuer approved by Fannie Mae or Freddie Mac provides an appropriate level of private mortgage insurance. Should OTS also permit other forms of credit enhancement (i.e., cash collateral or bond collateral) in determining whether a loan meets the LTV requirement under the capital rules? If so, what types of credit enhancement should be permitted? Specifically, should OTS allow other types of guarantees issued by third parties, such as irrevocable standby letters of credit? If so, please address how OTS may ensure the quality of these guarantees, particularly where the guarantor may be an affiliate of the institution.*

- *Should OTS permit a savings association to review periodically a loan on residential real property with an appreciating value to determine if the loan meets the LTV requirements for a lower risk-weight category? Similarly, should the OTS require a savings association to reevaluate a loan on residential real property with a declining value to determine whether the loan continues to meet the definition of a qualifying mortgage loan? Also should a minimum time elapse before an institution may use a revaluation to compute LTV?*

In addition to these matters, OTS has received several inquiries concerning the treatment of a mortgage loan that meets the prescribed LTV requirement on the date of its origination, but subsequently negatively amortizes to a higher LTV ratio. Some have argued that the current definition of qualifying mortgage loan merely requires a loan to meet the LTV requirement at its origination. OTS disagrees with this interpretation. Savings associations must maintain capital commensurate with the risk of the loan throughout the life of the loan. Accordingly, OTS proposes to clarify this matter in the proposed rule. Thus, the proposed rule would provide that a loan that has amortized above the LTV limit is not a qualifying mortgage loan and will not be accorded a 50 percent risk weight. OTS expects thrifts to review periodically loans structured with negative amortization features and loans that have the potential for negative amortization to ensure that the required LTV ratios are met. Thrifts must reassign a 100 percent risk weight to loans that amortize to an LTV ratio of 90 percent or more.

OTS solicits comment on whether the definition of qualifying mortgage loan in the final rule should include some types of loans that negatively amortize to an LTV of 90 percent or more. Some negatively amortizing loans may not result in additional credit risk. For example, a loan may negatively amortize solely because the interest rate changes. Under certain Adjustable Rate Mortgages (ARMs), the interest rate on the loan may be adjusted more frequently than the amount of the monthly payment. (For example, the interest rate on the loan is adjusted monthly, but the payment amount changes only every 6 months.) Negative amortization will occur when the interest rate increases and the monthly payment is not sufficient to cover the interest due. This type of loan may be less risky than comparable ARM loans because the borrower is less likely to be shocked by sudden payment increases.

On the other hand, other loan products are designed to negatively amortize whether or not interest rates increase. This could occur where a savings association holds a graduated payment mortgage (GPM). A GPM will have monthly payments that start out at a low level (ordinarily a lower level than for conventional mortgages) and gradually rise above the level where a conventional mortgage would have been written. Both the graduation rate and the interest rate on the principal amount may be fixed throughout the life of the loan. Because the initial payments may not be sufficient to cover the set interest rate on the loan, a GPM may negatively amortize. These types of loans appear to create additional credit risk because of several factors:

- they permit a borrower to qualify for a higher loan amount than he or she would qualify for under a comparable fixed mortgage,
- the loan is automatically subject to negative amortization early in the loan term, at a time when LTV is highest, and
- the borrower may be subject to significant payment increases, especially early in the loan term.

OTS solicits comments on the following issues regarding negatively amortizing loans.

- *Should loans that negatively amortize above the LTV limit be afforded 50 percent risk-weight treatment? If so, why?*
- *Should only some types of loans that amortize above the revised LTV limit be accorded 50 percent risk weight? Is it appropriate to distinguish between loans that are designed to negatively amortize and loans that negatively amortize solely as a result of changes in the interest rate? Should OTS distinguish between qualifying and nonqualifying negatively amortizing loans on some other basis?*
- *Identify specific types of negatively amortizing loan products that should be accorded a 50 percent risk weight. For example, how should OTS treat "pick a payment" loans? (These loans permit the borrower to periodically elect to make a monthly payment that is lower than the amount set on the payment schedule. These elections could cause the loan to negatively amortize.)*

B. Land Loans and Nonresidential Construction Loans

All of the Banking Agencies require depository institutions to apply a risk weight of 100 percent to land loans and nonresidential construction loans.[10] Only OTS, however, also requires savings associations to exclude from assets (and therefore from computations of total capital), that portion of a nonresidential construction or land loan that is above an 80 percent LTV ratio.[11]

OTS first adopted the capital deduction for nonresidential construction and land loans with high LTV ratios in 1989. At that time, OTS experience indicated that these types of loans presented particularly high levels of risk.[12] Since that time, however, OTS and the other Banking Agencies have issued guidelines specifically designed to address high LTV risk and concentrations of credit. For example, the Interagency Lending Guidelines place supervisory LTV limits on residential construction and land loans. Under the guidelines, LTVs should not exceed 65 percent for loans on raw land, 75 percent for loans for land development, 80 percent for commercial, multi-family and other nonresidential construction loans, and 85 percent for one- to four family construction loans.[13] While the guidelines permit some loans in excess of the supervisory limits under certain conditions, loans in excess of the supervisory limits are subject to a concentration limit. Specifically, all loans in excess of the supervisory limits should not exceed 100 percent of

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[10] 12 CFR part 3, App. A., Sec. 3(a)(4)(OCC): 12 CFR part 208, App. A., Sec. III. C.4.(FRB); 12 CFR part 325, App. A., Sec. II.C. (FDIC); 12 CFR 567.6(a)(1)(iv)(G) & (H) (OTS).

[11] Compare 12 CFR 567.5(c)(2)(3) with 12 CFR part 3, App. A., Sec. 2(c)(4)(OCC): 12 CFR part 208, App. A., Sec. II. B.(FRB); 12 CFR part 325, App. A., Sec. I.B. (FDIC).

[12] 54 FR 46845, 46863 (Nov. 8, 1989).

the institution's total capital.[14] The Interagency Lending Guidelines provide further guidance to institutions with regard to underwriting standards and loan portfolio management. OTS believes that this additional supervisory guidance adequately addresses the higher levels of risk in these loans. In light of this guidance, OTS concludes that the 100 percent risk weight sufficiently reflects the risks of these loans and that the additional direct deduction from capital is unnecessary.

Furthermore, OTS believes that the current capital treatment of nonresidential construction and land loans is overly burdensome when compared to the capital treatment of other types of loans of equal or greater risk. For example, an institution making a $90,000 loan on land appraised at $100,000 would be required to deduct $10,000 from total assets ($10,000 equals that portion of the $90,000 loan that is above the 80 percent LTV ratio). The remaining $80,000 would be risk weighted at 100 percent, resulting in a $6,400 risk-based capital charge. Thus, the effective capital charge for this $90,000 loan would be $16,400. By contrast, a $90,000 unsecured loan is risk weighted at 100 percent and would result in only a $7,200 capital charge.

This proposed change would also conform OTS capital requirements more closely to the rules of the other Banking Agencies. Without the deduction from total capital, OTS capital

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[13] Appendix to 12 CFR 560.101 (Supervisory loan-to-value limits).
[14] Appendix to 12 CFR 560.101 (Loans in excess of the supervisory loan-to-value limits). The Home Owners' Loan Act also limits the amount that a thrift may lend. For example, federal savings associations are authorized to make nonresidential real property loans in an amount up to 400 percent of total capital (12 U.S.C. 1464(c)(2)(B)), and to make additional commercial loans (which may or may not be secured by real estate) in an amount up to 20 percent of total assets (12 U.S.C. 1464(c)(2)(C)).

treatment of nonresidential construction and land loans for savings associations would be identical to that of the other Banking Agencies for banks.

C. Interest-Rate Risk Component

Section 305 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires OTS and the Banking Agencies to review their risk-based capital standards to ensure that those standards take adequate account of, among other things, interest rate risk.[15] To fulfill this requirement, OTS issued a final rule in 1993 adding an interest rate risk component (IRR component) to its risk-based capital regulation at 12 CFR 567.7.[16] This IRR component is an explicit capital deduction from total capital for the purposes of the risk-based capital requirement and is imposed on institutions with above-normal levels of interest rate risk. An institution's interest rate risk is measured by dividing the decline in net portfolio value that would result from a 200 basis point increase or decrease in interest rates by the present value of the institution's assets. The amount deducted from capital is equal to one-half the difference between the institution's measured interest rate risk and a "normal" measured interest rate risk (set at two percent), multiplied by the estimated market value of the institution's assets.[17]

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[15] 12 U.S.C. 1828 note.

[16] 58 FR 45799 (August 31, 1993).

[17] For example, if the decline in net portfolio value during a 200 basis point shock in interest rates is $3 million and the present value of the institution's assets is $100 million, the institution's measured IRR is 3 percent. The amount to be deducted from capital is $0.5 million, calculated as one-half the difference between the institution's measured IRR of 3 percent and a "normal" measured IRR of 2 percent multiplied by the $100 million of the present value of the institution's assets.

When OTS adopted its final interest-rate-risk rule, the other Banking Agencies had not yet finalized their related rules. Accordingly, the OTS final rule stated that if the other Banking Agencies adopted an IRR component significantly different from the OTS requirement, OTS would review its requirement to determine whether any adjustment was needed in the interest of competitive equality. In fact, the other Banking Agencies never adopted an interest-rate-risk rule and the Acting OTS Director waived the effective date of the rule twice[18]; the OTS rule has never gone into effect.

In the years following the promulgation of the interest rate risk rule, OTS has gained considerable experience in the regulation of interest rate risk. Based on this experience, OTS issued Thrift Bulletin 13a (TB 13a) "Management of Interest Rate Risk, Investment Securities, and Derivative Activities." TB 13a updated and superseded TB 13, which had been adopted in 1989 and which provided guidance on management of interest rate risk and the responsibilities of

[18] CEO Letters from Jonathan L. Fiechter, Acting Director (Oct. 13, 1994 and Mar. 20, 1995).

boards of directors in that area.[19] TB 13a updated OTS minimum standards for thrift institutions' interest rate risk management practices with regard to board-approved risk limits and interest rate risk measurement systems.

OTS has also enhanced - and continues to upgrade – its interest rate risk model (IRR Model), which measures an institution's interest rate risk by focusing on changes in its net portfolio value brought about by changes in interest rates. The IRR Model provides OTS with a means of identifying institutions with high levels of interest rate risk exposure, improves the analysis of industry-wide interest rate risk, and facilitates dialogue between examiners and thrift managers by focusing on areas that warrant the most attention.

Finally, OTS has in place regulations at ⊗ 563.176 requiring the adoption of interest rate risk management procedures and ⊗ 567.3, which includes interest rate risk among the factors to be considered in establishing individual minimum capital requirements.

In a 1998 final rulemaking on financial derivatives, a commenter urged OTS to delete the IRR component of the capital rule. OTS concluded that a review of retaining § 567.7 might have merit, and indicated that it would initiate a separate rulemaking to evaluate the retention of this rule.[20]

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[19] 63 FR 66361 (Dec. 1, 1998).

[20] 63 FR 66348, 66349 (Dec. 1, 1998).

OTS has reviewed the IRR component and has concluded that the explicit capital deduction under § 567.7 is not necessary in light of the other tools that are currently available to measure and control interest rate risk. OTS believes the IRR model, the interest rate risk management procedures at § 563.176, the individual minimum capital requirements at § 567.3, and TB 13a provide a comprehensive interest rate risk program. This program provides adequate guidance to savings associations and generates sufficient information for OTS to monitor interest rate risk. OTS will continue to review and consider the adoption of other tools and methods to control and measure interest rate risk as these tools and methods are developed.

OTS believes that the individual minimum capital requirement at § 567.3 satisfies the FDICIA requirement that its risk-based capital standards take adequate account of interest rate risk. As noted above, this regulation permits OTS to impose an individual minimum capital requirement for institutions that exhibit a high degree of exposure to interest rate risk.[21] This approach is substantively similar to the Banking Agencies' implementation of section 305 of the FDICIA.[22]

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[21] 12 CFR 567.3(b)(3).

[22] 12 CFR 3.10(e) (OCC); 12 CFR part 208, App.B., Sec. II.a (FRB); 12 CFR 325.3(a) (FDIC).

Accordingly, OTS proposes to delete § 567.7. As a related matter, OTS is proposing a change to the risk weight for high quality, stripped, mortgage related securities (discussed below). It would also make a minor conforming change to § 567.5, which defines total capital.

D. High Quality, Stripped, Mortgage-Related Securities

Prior to 1993, OTS assigned high-quality, stripped, mortgage-related securities to the 100 percent risk-weight category. When OTS adopted the IRR component in 1993, however, it reduced this risk weight to 20 percent.[23] This change was justified because the bulk of the risk in these instruments is interest rate risk, which the agency anticipated would be addressed through the IRR component. In today's rulemaking, OTS has proposed to remove the interest rate risk component. Accordingly, OTS is reconsidering the appropriate risk weight for high quality, stripped, mortgage-related securities.

The other Banking Agencies apply a 100 percent risk weight to all stripped, mortgage-related securities, regardless of the issuer or guarantor.[24] To achieve greater uniformity between OTS and the Banking Agencies and to ensure that OTS risk-based capital regulations reflect the general level of risk commensurate with most of these securities, OTS proposes to apply a 100

[23] 58 FR 45799, 45801 (Aug. 31, 1993). See 12 CFR 567.6(a)(1)(ii)(H).

[24] 12 CFR part 3, App. A., Sec. 3(a)(4)(iv) (OCC); 12 CFR part 208, App. A., Sec. III.C.4.(FRB); 12 CFR part 325, App. A., Sec. II.C.4.(FDIC).

percent risk weight to all stripped, mortgage-related securities, regardless of the issuer or guarantor. OTS requests comment on this change and on the following questions:

- *Is the 100 percent risk weight the appropriate risk category for this asset?*
- *Should interest-only, stripped, mortgage-related securities be treated differently for risk-weight purposes than principal-only, stripped, mortgage-related securities?*
- *Should risk weights be determined based upon the issuer or guarantor of the securities?*

E. OECD-Based Country

Under existing OTS regulations, certain assets that are supported by the credit standing of the central government of, public-sector entities in, or depository institutions incorporated in Organization for Economic Cooperation and Development (OECD) based countries, receive preferential capital risk weighting over similar entities in non OECD-based countries. For example, the portion of assets conditionally guaranteed by the central government of an OECD country receives a 20 percent risk weight. The portion of assets conditionally guaranteed by the central government of a non-OECD country receives a 100 percent risk weight.[25]

OTS regulations define "OECD-based country" as a member of the grouping of countries that are full members of the OECD, plus countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General

[25] 12 CFR 567.6(a)(1)(ii)(C) and 567.6(a)(1)(iv).

Arrangements to Borrow. OTS's definition for OECD-based country differs from the definitions used by the Banking Agencies. Specifically, OTS does not exclude countries that have rescheduled their external sovereign debt within the previous five years.[26] Thus, OTS's definition applies the preferential risk weighting to a broader range of assets than the Banking Agencies' definitions.

This difference arose in 1995 when the FRB, OCC, and FDIC issued a joint final rule modifying their risk-based capital guidelines.[27] The Banking Agencies made this change to make their rules more consistent with the "International Convergence of Capital Measurement and Capital Standards" (Basle Accord). OTS did not join this rulemaking. To achieve greater uniformity between OTS and the Banking Agencies, and to make OTS rules more consistent with the Basle Accord, OTS proposes to revise its definition to exclude countries that have rescheduled external sovereign debt within the previous five years.[28]

F. Allowance for Loan and Lease Losses

Under current OTS capital rules, supplemental capital includes general valuation loan and lease loss allowances established pursuant to regulations and memoranda of OTS up to a

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[26] Compare 12 CFR 567.1 with 12 CFR part 3, App. A., Sec.1(c)(17) (OCC); 12 CFR part 208, App. A., Sec.III.B.1.fn.22 (FRB); and 12 CFR part 325, App. A., Sec. II.B.2.fn.12 (FDIC).

[27] 60 FR 66042 (Dec. 20, 1995).

[28] This change is also consistent section 5(t)(1)(C) of the HOLA and section 303 of CDRIA, which are discussed above.

maximum of 1.25 percent of risk-weighted assets. See 12 CFR 567.5(b)(4). OTS proposes to change the term "general valuation loan and lease loss allowances" to "allowance for loan and lease losses" to conform OTS's rule to that of the other federal banking agencies. This proposed change is a technical change and should not effect the capital treatment of reserves for loan and lease losses. The Thrift Financial Report (TFR) and the instructions to the TFR use the term allowance for loan and lease losses in this context. See Schedule CCR and Instructions to CCR350 (Allowance for Loan and Lease Losses).

G. Other Changes

One of the primary purposes of this rule is to align OTS capital rules for thrifts more closely to those of the other agencies for banks. OTS specifically requests comment whether it should address and eliminate any other capital differences between OTS rules and the rules of the other agencies.[29]

III. Plain Language Requirement

Section 722 of the Gramm-Leach-Bliley Act of 1999 requires OTS to use "plain language" in all proposed and final rules published after January 1, 2000. We invite your comments on how to make this proposed rule easier to understand. For example:

(1) Have we organized the material to suit your needs?

(2) Are the requirements in the rule clearly stated?

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[29] For example, compare the OTS conversion factor matrix for derivative contracts at 12 CFR 567.6(a)(2)(v)(A)(2) with 12 CFR part 3, App. A., Sec. 3(b)(5)(B)(i)(OCC matrix); 12 CFR part 208, App. A., Sec. III.E.2.c (FRB

matrix); 12 CFR part 325, App. A., Sec. II.E.3. (FDIC matrix).

(3) Does the rule contain technical language or jargon that isn't clear?

(4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand?

(5) Would more (but shorter) sections be better?

(6) What else could we do to make the rule easier to understand?

IV. Executive Order 12866

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

V. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Director of OTS has certified that this proposed rule does not have a significant economic impact on a substantial number of small entities.

VI. Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year.

OTS has determined that the effect of this proposed rule will not result in expenditures by State, local, or tribal governments or by the private sector of $100 million or more. Accordingly, OTS has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

List of Subjects in 12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.

Accordingly, the Office of Thrift Supervision proposes to amend part 567, chapter V, title 12, Code of Federal Regulations as set forth below:

PART 567--CAPITAL

1. The authority citation for part 567 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828 (note).

2. Section 567.1 is amended by revising the definitions of “OECD-based country” and “qualifying mortgage loan” as follows:

§ 567.1 Definitions.

* * * * *

OECD-based country. The term OECD-based country means a member of that grouping

of countries that are full members of the Organization for Economic Cooperation and Development (OECD) plus countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements to Borrow. This term excludes any country that has rescheduled its external sovereign debt within the previous five years. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.

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Qualifying mortgage loan. The term qualifying mortgage loan means a one- to four-family residential first mortgage loan that is prudently underwritten, is performing, is not more than 90 days past due, and has a documented loan-to-value ratio below 90 percent at all times during the life of loan.

(1) A loan meets the loan-to-value ratio requirement if the loan is paid down to a loan-to-value ratio under 90 percent and continues to maintain such a ratio during the remainder of its life.

(2) A loan also meets the loan-to-value ratio requirement if the loan is insured to less than a 90 percent loan-to-value ratio by private mortgage insurance provided by an issuer approved by Fannie Mae or Freddie Mac.

(3) If a savings association holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a

first lien for the purposes of determining the loan-to-value ratio and the appropriate risk weight under § 567.6(a).

(4) Loans to individual borrowers for the construction of their own homes may be included as qualifying mortgage loans.

* * * * *

3. Section 567.5 is amended by: revising paragraph (b)(4) and footnote 7 to paragraph (b)(4) as set forth below; adding "and" to the end of paragraph (c)(2)(i); adding a period in place of ", and" at the end of paragraph (c)(2)(ii); and removing paragraphs (c)(2)(iii) and (c)(3).

§ 567.5 Components of Capital

* * * * *

(b) * * *

(4) Allowance for loan and lease losses. Allowance for loan and lease losses established under regulations and memoranda of the Office up to a maximum of 1.25 percent of risk-

weighted assets.[7]

* * * * *

4. Section 567.6 is amended by revising paragraphs (a)(1)(ii)(H), (a)(1)(iv)(G) and (a)(1)(iv)(H), to read as follows:

§ 567.6 Risk-based capital credit risk-weight categories.

(a) * * *

(1) * * *

(ii) * * *

(H) High quality mortgage-related securities, except those with residual characteristics or stripped mortgage-related securities.

* * * * *

(iv)* * *

(G) Land loans;

(H) Nonresidential construction loans;

* * * * *

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[7] The amount of the allowance for loan and lease losses that may be included in capital is based on a percentage of risk-weighted assets. The gross sum of risk-weighted assets used in this calculation includes all risk-weighted assets, with the exception of assets required to be deducted under § 567.6 in establishing risk-weighted assets. "Excess reserves for loan and lease losses" is defined as assets required to be deducted from capital under § 567.5(a)(2). A savings association may deduct excess reserves for loan and lease losses from the gross sum of risk-weighted assets (i.e., risk-weighted assets including allowance for loan and lease losses) in computing the denominator of the risk-based capital standard. Thus, a savings association will exclude the same amount of

§ 567.7 [Removed]

5. Section 567.7 is removed.

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By the Office of Thrift Supervision.

/s/

Ellen Seidman
Director

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excess allowance for loan and lease losses from both the numerator and the denominator of the risk-based capital ratio.