

IMPORTANT INFORMATION ABOUT THE ADJUSTABLE MORTGAGE LOAN— PLEASE READ CAREFULLY

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

General Description of Adjustable Mortgage Loan

The adjustable mortgage loan is a flexible loan instrument. Its interest rate may be adjusted by the lender from time to time. Such adjustments will result in increases or decreases in your payment amount, in the outstanding principal loan balance, in the loan term, or in all three (see discussion below relating to these types of adjustments). Federal regulations place no limit on the amount by which the interest rate may be adjusted either at any one time or over the life of the loan, or on the frequency with which it may be adjusted. Adjustments to the interest rate must reflect the movement of a single, specified index (see discussion below). This does not mean that the particular loan agreement you sign must, by law, permit unlimited interest-rate changes. It merely means that, if you desire to have certain rate-adjustment limitations placed in your loan agreement, that is a matter you should negotiate with the lender. You may also want to make inquiries concerning the loan terms offered by other lenders on AMLs to compare the terms and conditions.

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

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

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

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

Index

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

[Name and description of index to be used for applicant's loan, initial index value (if known) or date of initial index value, a source or sources where the index may be readily obtained by the borrower, and the high and low index rates during the previous calendar year.]

KEY TERMS OF FEDERAL SAVINGS AND LOAN ASSOCIATION'S ADJUSTABLE MORTGAGE LOAN

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

[Provide summary of basic terms of the loan, including the loan term, the frequency of rate changes, the frequency of payment changes, the maximum rate change, if any, at one time, the maximum rate change, if any, over the life of the loan, the maximum payment change, if any, at one time, minimum increments, if any, of rate changes, and whether there will be adjustments to the principal loan balance, in the following format:
Loan term _____
Frequency of rate changes _____
Frequency of payment changes _____]

How Your Adjustable Mortgage Loan Would Work

Initial Interest Rate

The initial interest rate offered by _____ Federal Savings and Loan Association on your AML will be established and disclosed to you on [commitment date, etc.] based on market conditions at the time.

[Insert a short description of each of the key terms of the type of AML to be offered to the borrower, using headings where appropriate.]

Notice of Payment Adjustments

_____ Federal Savings and Loan Association will send you notice of an adjustment to the payment amount at least 30 but not more than 45 days before it becomes effective. [Describe what information the notice will contain.]

Prepayment Penalty

You may prepay an AML in whole or in part without penalty at any time during the term of the loan.

Fees

You will be charged fees by _____ Federal Savings and Loan Association and by other persons in connection with the origination of

your AML. The association will give you an estimate of these fees after receiving your loan application. However, you will not be charged any costs or fees in connection with any regularly-scheduled adjustment to the interest rate, the payment, the outstanding principal loan balance, or the loan term initiated by the lender.

Example of Operation of Your Type of AML

[Set out an example of the operation of the type of AML to be offered to the borrower, including, where appropriate, the use of a table.]

(g) *Transition period.* Until July 31, 1981, associations may continue to make, purchase, participate or otherwise deal in variable-rate mortgage loans pursuant to § 545.6-4(c) of this Part or renegotiable-rate mortgage loans pursuant to § 545.6-4a of this Part, as those sections were constituted prior to April 30, 1981.

(Sec. 5, 48 Stat. 132, as amended (12 U.S.C. 1464); Reorg. Plan No. 3 of 1947; 3 CFR, 1943-1948 Comp., p. 1071)

By the Federal Home Loan Bank Board.

J. J. Finn,

Secretary.

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 741

[IRPS 81-3]

Statement of Interpretation and Policy; State Chartered Federally Insured Credit Unions as "Most Favored Lenders"

AGENCY: National Credit Union Administration.

ACTION: Statement of Interpretation and Policy.

SUMMARY: In IRPS 80-11 NCUA stated that it would interpret Section 205(g)(1) of the Federal Credit Union Act to accord "most favored lender" status to a state chartered federally insured credit union. This status would be triggered only when the interest rate the credit union could normally charge on a loan was less than the discount rate plus one percent. If triggered, this status would apply only when the credit union granted a loan other than a first mortgage loan, a business loan of \$1000 or more, or an agricultural loan of \$1000 or more. This document replaces IRPS 80-11. It removes the trigger mechanism and states that the "most favored lender" status will apply to any loan the credit union grants.

EFFECTIVE DATE: April 1, 1980 (the effective date of Pub. L. 96-221).

FOR FURTHER INFORMATION CONTACT:

John L. Culhane, Jr., Senior Attorney, or Barbara A. Burrows, Attorney-Advisor, Office of General Counsel, National Credit Union Administration, 1776 G Street, NW, Washington, D.C. 20456. Telephone: (202) 357-1030.

SUPPLEMENTARY INFORMATION: Pub. L. 96-221, the Depository Institutions Deregulation and Monetary Control Act of 1980, added Section 205(g)(1) to the Federal Credit Union Act. Section 205(g)(1) reads as follows:

If the applicable rate prescribed in this subsection exceeds the rate an insured credit union would be permitted to charge in the absence of this subsection, such credit union may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this subsection, take, receive, reserve, and charge on any loan, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve District where such credit union is located or at the rate allowed by the laws of the State, territory, or district where such credit union is located, whichever may be greater.

In IRPS 80-11 NCUA stated that it would interpret this Section to grant "most favored lender" status to state chartered federally insured credit unions. This status would be triggered whenever one per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve District where a credit union was located was higher than the rate the credit union could normally charge on a loan other than a first mortgage loan, a business loan of \$1000 or more, or an agricultural loan of \$1000 or more. Once triggered, the credit union would have two options. It could charge up to one per centum in excess of that discount rate or it could charge any rate any other lender could charge on that loan under state law, whichever would be greater. 45 FR 78624 (1980).

After the IRPS was published, credit unions and credit union trade associations requested that NCUA reconsider certain aspects of its interpretation. While the commenters agreed with NCUA that Section 205(g)(1) grants "most favored lender" status to state chartered federally insured credit unions, they argued for certain changes in the interpretation. Two of the commenters' arguments are being addressed in this IRPS. First, they argued that the statute could be interpreted in such a way as to eliminate the trigger mechanism. Second, they

argued that the statute could be interpreted in such a way as to accord "most favored lender" status regardless of the type of loan being granted.

The trigger mechanism was imposed based on NCUA's interpretation of the phrase, "the applicable rate prescribed in this subsection." Although noting that the phrase was not entirely clear, NCUA interpreted the phrase to refer to one percent over the discount rate for ninety-day commercial paper, as that rate was the only rate specifically set out in Section 205(g)(1). In addition, this interpretation seemed to be consistent with certain references in the legislative history of Pub. L. 96-221. See Conf. Rep. No. 842, 96th Cong., 2d Sess. 78 (1980).

The commenters argued that an equally supportable reading of the phrase would be that "the applicable rate prescribed in this subsection" refers both to one percent over the discount rate for ninety-day commercial paper and to the rate allowed by the laws of the state, territory, or district where the credit union is located. It was further argued that this interpretation would be more consistent with the Congressional intent of placing state chartered federally insured credit unions in parity with national banks. And it was also argued that this interpretation would avoid the operational problems associated with a trigger mechanism. The NCUA Board is persuaded by these arguments and has revised its interpretation accordingly.

The limitation on the loans that could be granted by a credit union as a "most favored lender" was imposed based on NCUA's interpretation of the structure of Title V of Pub. L. 96-221. Title V contained three parts. Part A was entitled, "Mortgage Usury Laws." Part B was entitled, "Business and Agricultural Loans." Part C was entitled, "Other Loans." Section 205(g)(1) was added by Part C; hence it appeared that it applied only to loans that were not covered by Parts A or B.

The commenters argued that an equally supportable reading would be that a loan could be made at the greatest rate permissible under either Parts A, B, or C. It was further argued that this interpretation would be more consistent with the Congressional intent of placing state chartered federally insured credit unions in parity with national banks. And it was also argued that this interpretation was supported by Section 528 of Pub. L. 96-221 which, in pertinent part, states that: "In any case in which one or more provisions of, or amendments made by . . . this title [i.e. Title V] . . . apply with respect to the same loan, mortgage, credit sale, or

advance, such loan, mortgage, credit sale, or advance may be made at the highest possible rate." The NCUA Board finds these arguments persuasive and has revised its interpretive ruling accordingly.

However, the Board once again cautions state chartered federally insured credit unions that Section 525 of Pub. L. 96-221 permits a state to elect not to have Section 205(g)(1) of the Federal Credit Union Act apply in that state. Before granting loans under the authority of Section 205(g)(1) and this interpretive ruling, a state credit union should contact its state supervisory agency to determine whether or not Section 205(g)(1) has been superceded.

According to the NCUA Board cancels IRPS No. 80-11 and in its place adopts the following.

Text of Statement of Interpretation and Policy [IRPS 81-3]

Section 205(g)(1) of the Federal Credit Union Act states that:

If the applicable rate prescribed in this subsection exceeds the rate an insured credit union would be permitted to charge in the absence of this subsection, such credit union may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this subsection, take, receive, reserve, and charge on any loan, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the insured credit union is located or at the rate allowed by the laws of the State, territory, or district where such credit union is located, whichever may be greater.

NCUA interprets this Section to grant "most favored lender" status to state chartered federally insured credit unions. On any particular class of loans, state chartered federally insured credit unions may charge interest at a rate not to exceed the greater of one percent over the discount rate on ninety-day commercial paper or the rate allowed to the "most favored lender" on the particular class of loans under state law, provided the greater of either of these rates exceeds the rate state chartered federally insured credit unions are normally permitted to charge under state law.

Rosemary Brady,

Secretary NCUA Board.

April 24, 1981.

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