Comptroller of the Currency
Administrator of National Banks
US Department of the Treasury

RESCINDED

OCC 2007-11

Subject: Subprime Mortgage Lending
Date: March 8, 2007

To: Chief Executive Officers of All National Banks, Federal Branches and Agencies, Department and Division Heads, and All Examining Personnel

Description: Request for Comment on Proposed Statement on Subprime Mortgage Lending

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supplement the agencies' existing guidance on subprime lending programs (OCC Bulletins 1999-10 and 2001-6) and the 1993 *Interagency Guidelines for Real Estate Lending*.

As the mortgage market has grown and evolved in recent years, a number of subprime hybrid products have been offered to a wider spectrum of borrowers. Some of these products include loans that are intended at their outset to be temporary credit accommodations in anticipation of early sale or refinancing, rather than longer-term amortizing accounts. Such loans typically are hybrid ARMs and involve terms that may exceed the borrower' ability to service the debt without refinancing or selling the property. This fundamental shift in the purpose and actual repayment expectations of subprime loan programs has resulted in elevated credit risk and heightened concerns about borrowers' understanding of the risks of such loans.

The agencies are concerned particularly with ARM products marketed to subprime borrowers that include features such as: initial payments based on an introductory rate that is considerably lower than the fully indexed rate; very high or no limits on payment or interest rate increases; substantial prepayment penalties and/or prepayment penalties that extend beyond the initial interest rate adjustment period; and inadequate information to borrowers relative to product features, material loan terms, and product risks. To address these concerns, the proposed Statement specifies that an institution should evaluate a borrower's ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. It also encourages institutions that impose prepayment penalties to structure them in such a way that they do not extend beyond the initial reset periods. The Statement also underscores that communications with consumers should provide clear and balanced information about the relative benefits and risks of the products.

As with the agencies' guidance on nontraditional mortgages, the proposed Statement, when finalized, will apply to all banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, and credit unions.

The notice and request for comment on the proposed Statement was published in the *Federal Register* on March 8, 2007. The agencies are requesting comments on all aspects of the proposed Statement and are particularly interested in public comment about whether: 1) these arrangements always present inappropriate risks to institutions and consumers or whether and under what circumstances they are appropriate; 2) the proposed Statement would unduly restrict existing subprime borrowers' ability to

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refinance their loans; 3) other forms of credit are available that would not present the risk of payment shock; 4) the principles of the proposed Statement should be applied beyond the subprime ARM market; and 5) an institution's policy limiting prepayment penalties to the initial fixed-rate period would assist consumers by providing them sufficient time to assess and act on their mortgage needs.

Comments on the proposed Statement are due on or before May 7, 2007.

For further information, contact Stephen Jackson, Director, Retail Credit, (202) 874-5170, or Michael S. Bylsma, Director, Community and Consumer Law Division, (202) 874-5750.

Emory W. Rushton
Senior Deputy Comptroller and Chief National Bank Examiner

Related Links

- Proposed Statement 72 FR 10533

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket No. OCC–2007–0005]

FEDERAL RESERVE SYSTEM

[Docket No. OP–1278]

FEDERAL DEPOSIT INSURANCE CORPORATION

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

[No. 2007–09]

NATIONAL CREDIT UNION ADMINISTRATION

Proposed Statement on Subprime Mortgage Lending

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); and National Credit Union Administration (NCUA).

ACTION: Notice with request for comment.

SUMMARY: The OCC, Board, FDIC, OTS, and NCUA (the Agencies) request comment on this proposed Statement on Subprime Mortgage Lending. The proposed statement addresses emerging issues and questions relating to certain subprime mortgage lending practices, and it discusses risk management and consumer compliance processes, policies, and procedures that institutions should implement to respond to these concerns.

DATES: Comments must be submitted on or before May 7, 2007.

ADDRESSES: The Agencies will jointly review all of the comments submitted. Therefore, interested parties may send comments to any of the Agencies and need not send comments (or copies) to all of the Agencies. Please consider submitting your comments by e-mail or fax, since paper mail in the Washington area and at the Agencies is subject to delay. Interested parties are invited to submit comments to:

OCC: You should include ''OCC'' and Docket Number OCC–2007–0005 in your comment. You may submit your comment by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *OCC Web Site: http://www.occ.treas.gov.* Click on ''Contact the OCC,'' scroll down and click on ''Comments on Proposed Regulations.''
- *E-Mail Address: regs.comments@occ.treas.gov.*
- *Fax:* (202) 874–4448.
- *Mail:* Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 1–5, Washington, DC 20219.
- *Hand Delivery/Courier:* 250 E Street, SW., Attn: Public Information Room, Mail Stop 1–5, Washington, DC 20219.

Instructions: In general, the OCC will enter all comments received into the docket without change, including any business or personal information that you provide.

You may review comments and other related materials by any of the following methods:

- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC. You can make an appointment to inspect comments by calling (202) 874–5043.
- *Viewing Comments Electronically:* You may request that we send you an electronic copy of comments via e-mail or mail you a CD–ROM containing electronic copies by contacting the OCC at *regs.comments@occ.treas.gov.*
- *Docket Information:* You may also request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. OP–1278, by any of the following methods:

- *Agency Web site: http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov.* Include the docket number (OP–1278) in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments also may be viewed electronically or in paper form in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- *Agency Web Site: http://www.fdic.gov/regulations/laws/federal.* Follow instructions for submitting comments on the Agency Web Site.
- *E-mail: Comments@FDIC.gov.* Include ''Statement on Subprime Mortgage Lending'' in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EST).
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Public Inspection: All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal* including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E–1002, Arlington, VA 22226, between 9 a.m. and 5 p.m. (EST) on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275–3342 or (703) 562–2200.

OTS: You may submit comments, identified by docket number 2007–09, by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail address: regs.comments@ots.treas.gov.* Please include docket number 2007–09 in the subject line of the message and include your name and telephone number in the message.
- *Fax:* (202) 906–6518.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: No. 2007–XX.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days. Address envelope as

follows: Attention: Regulation Comments, Chief Counsel's Office, Attention: No. 2007–09.

Instructions: All submissions received must include the agency name and docket number for this proposed Statement. All comments received will be posted without change to the OTS Internet Site at *http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1*, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to *http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1.* In addition, you may inspect comments at the OTS's Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to *public.info@ots.treas.gov*, or send a facsimile transmission to (202) 906–7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

NCUA: You may submit comments by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *NCUA Web site: http://www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/proposed_regs.html.* Follow the instructions for submitting comments.
- *E-mail:* Address to *regcomments@ncua.gov.* Include ''[Your name] Comments on '' in the e-mail subject line.
- *Fax:* (703) 518–6319. Use the subject line described above for e-mail.
- *Mail:* Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
- *Hand Delivery/Courier:* Same as mail address.

FOR FURTHER INFORMATION CONTACT:

OCC: Michael S. Bylsma, Director, Community and Consumer Law Division, (202) 874–5750 or Stephen Jackson, Director, Retail Credit Risk, (202) 874–5170.

Board: Division of Banking Supervision and Regulation: Brian Valenti, Supervisory Financial Analyst, (202) 452–3575, Virginia Gibbs, Senior Supervisory Financial Analyst, (202) 452–2521, or Sabeth Siddique, Assistant Director, (202) 452–3861; Division of Consumer and Community Affairs: Kathleen Ryan, Counsel, (202) 452–3667, or Jamie Goodson, Attorney, (202) 452–3667; or Legal Division: Stephanie Martin, Associate General Counsel, (202) 452–3198. Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Users of Telecommunication Device for Deaf (TTD) only, call (202) 263–4869.

FDIC: Suzy S. Gardner, Examination Specialist, (202) 898–3640, Division of Supervision and Consumer Protection; Richard Foley, Counsel, (202) 898–3784, Legal Division; or April Breslaw, Acting Associate Director, Compliance Policy & Exam Support Branch, (202) 898–6609, Division of Supervision and Consumer Protection.

OTS: Tammy Stacy, Director of Consumer Regulation, Compliance and Consumer Protection Division, (202) 906–6437; Glenn Gimble, Senior Project Manager, Compliance and Consumer Protection Division, (202) 906–7158, William Magrini, Senior Project Manager, Credit Risk, (202) 906–5744; or Teresa Luther, Economist, Credit Risk, (202) 906–6798.

NCUA: Cory Phariss, Program Officer, Examination and Insurance, (703) 518–6618.

SUPPLEMENTARY INFORMATION:

I. Background

This proposed Statement on Subprime Mortgage Lending (Statement) discusses criteria and factors, including payment shock, that an institution should assess in determining a borrower's ability to repay a subprime loan. The Statement also discusses consumer protection issues and practices, including reminders about some of the existing statutes, regulations, and guidance intended to protect consumers from unfair, deceptive, and other predatory practices. Finally, the Statement discusses the need for policies, procedures, and systems to assure that institutions' subprime mortgage lending is conducted in a safe and sound manner. The Statement is contained in Section II, below. The Agencies [1] request comment on all aspects of the Statement, including, but not limited to, the specific questions that appear in Section III.

II. Proposed Statement on Subprime Mortgage Lending

The Agencies developed this Statement to address emerging issues and questions relating to certain subprime [2] mortgage lending practices. The Agencies are concerned that subprime borrowers may not fully understand the risks and consequences of obtaining certain adjustable-rate mortgage (ARM) products. In particular, the Agencies are concerned with ARM products marketed to subprime borrowers with the following characteristics:

- Offering low initial payments based on a fixed introductory or ''teaser'' rate that expires after a short initial period then adjusts to a variable index rate plus a margin for the remaining term of the loan; [3]
- Approving borrowers without considering appropriate documentation of their income;
- Setting very high or no limits on how much the payment amount or the interest rate may increase (''payment or rate caps'') at reset periods, potentially causing a substantial increase in the monthly payment amount ''payment shock''; [4]
- Containing product features likely to result in frequent refinancing to maintain an affordable monthly payment;
- Including substantial prepayment penalties and/or prepayment penalties that extend beyond the initial interest rate adjustment period; and/or
- Providing borrowers with inadequate information relative to product features, material loan terms and product risks, prepayment penalties, and the borrower's obligations for property taxes and insurance.

The consequences to subprime borrowers could include: Being unable to afford the monthly payments after the initial rate adjustment because of payment shock; experiencing difficulty in paying real estate taxes and

[1] The Agencies consist of the Board of Governors of the Federal Reserve System (the Board), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), collectively the Agencies.

[2] The term ''subprime'' is defined in the 2001 Expanded Guidance for Subprime Lending Programs. Federally insured credit unions should refer to LCU 04–CU–13—Specialized Lending Activities.

[3] For example, ARMs known as ''2/28'' loans feature a fixed rate for two years and then adjust to a variable rate for the remaining 28 years. The spread between the initial fixed rate of interest and the fully indexed interest rate in effect at loan origination typically ranges from 300 to 600 basis points.

[4] Payment shock refers to a significant increase in the amount of the monthly payment that occurs when the interest rate adjusts to a fully indexed basis. Products with a wide spread between the initial interest rate and the fully indexed interest rate that do not have payment caps or periodic interest rate caps, or that contain very high caps can produce significant payment shock.

homeowners insurance that were not escrowed; incurring expensive refinancing fees frequently due to closing costs and prepayment penalties, especially if the prepayment penalty period extends beyond the rate adjustment date; and losing their home. The Agencies also are concerned about the elevated credit risk that is inherent in these products.

The Agencies note that many of these concerns are addressed in existing interagency guidance. The most prominent are the 1993 Interagency Guidelines for Real Estate Lending (Real Estate Guidelines), the 1999 Interagency Guidance on Subprime Lending (Subprime Lending Guidance), and the 2001 Expanded Guidance for Subprime Lending Programs (Expanded Subprime Guidance).[5]

While the 2006 Interagency Guidance on Nontraditional Mortgage Product Risks (NTM Guidance) may not explicitly pertain to products with the characteristics addressed in this Statement, it outlines prudent underwriting and consumer protection principles that institutions should also consider with regard to subprime mortgage lending. This Statement reiterates many of the principles addressed in existing guidance relative to prudent risk management practices and consumer protection laws.[6]

Risk Management Practices

Predatory Lending Considerations

Institutions marketing subprime mortgage loans should ensure that they do not engage in the type of predatory lending practices discussed in the Expanded Subprime Guidance. Typically, predatory lending involves at least one, and perhaps all three, of the following elements:

- Making mortgage loans based predominantly on the foreclosure or liquidation value of a borrower's collateral rather than on the borrower's ability to repay the mortgage according to its terms;
- Inducing a borrower to repeatedly refinance a loan in order to charge high points and fees each time the loan is refinanced (''loan flipping''); or
- Engaging in fraud or deception to conceal the true nature of the mortgage loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower.

Institutions marketing mortgage loans such as these carry an elevated risk that their conduct will violate Section 5 of the Federal Trade Commission Act (FTC Act), which prohibits unfair or deceptive acts or practices.[7]

Underwriting Standards

Institutions should refer to the Real Estate Guidelines, which provide underwriting standards for all real estate loans.[8] The Real Estate Guidelines state that prudently underwritten real estate loans should reflect all relevant credit factors, including the capacity of the borrower to adequately service the debt.[9] The 2006 NTM Guidance details similar criteria for qualifying borrowers for products that may result in payment shock.

Prudent qualifying standards recognize the potential effect of payment shock in evaluating a borrower's ability to service debt. An institution's analysis of a borrower's repayment capacity should include an evaluation of the borrower's ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. One widely accepted approach in the mortgage industry is to quantify a borrower's repayment capacity by a debt-to-income (DTI) ratio. An institution's DTI analysis should assess a borrower's total monthly housing-related payments (e.g., principal, interest, taxes, and insurance, or ''PITI'') as a percentage of gross monthly income.

This assessment is particularly important if the institution relies upon reduced documentation or allows other forms of risk layering. Risk-layering features in a subprime mortgage loan may significantly increase the risks to both the institution and the borrower. Therefore, an institution should have clear policies governing the use of risk-layered features, such as reduced documentation loans or simultaneous-second lien mortgages. When risk-layering features are combined with a mortgage loan, an institution should demonstrate the existence of effective mitigating factors that support the underwriting decision and the borrower's repayment capacity.

The higher a loan's risk, either from loan features or borrower characteristics, the more important it is to verify the borrower's income, assets, and liabilities. When underwriting higher risk loans, stated income and reduced documentation should be accepted only if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity. For many borrowers, institutions should be able to readily document income using recent W–2 statements, pay stubs or tax returns. A higher interest rate is not considered an acceptable mitigating factor.

Consumer Protection Principles

Fundamental consumer protection principles relevant to the underwriting and marketing of mortgage loans include:

- Approving loans based on the borrower's ability to repay the loan according to its terms, and
- Providing information that enables consumers to understand material terms, costs, and risks of loan products at a time that will help the consumer select products and choose among payment options.

When applying these principles to ARMs marketed to subprime borrowers described in this document, communications with consumers, including advertisements, oral statements, and promotional materials should provide clear and balanced information about the relative benefits and risks of the products. This information should be provided in a timely manner to assist consumers in the product selection process, not just upon submission of an application or at consummation of the loan. Institutions should not use such communications to steer consumers to these products to the exclusion of other products offered by the institution for which the consumer may qualify.

Information provided to consumers should clearly explain the risk of

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[5] Federally insured credit unions should refer to LCU 04–CU–13—Specialized Lending Activities. National banks should also refer to 12 CFR 34.3(b) and (c), as well as 12 CFR part 30, Appendix C.

[6] As with the Interagency Guidance on Nontraditional Mortgage Product Risks, 71 FR 58609 (October 4, 2006), this Statement applies to all banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, and credit unions.

[7] The OCC, the Board, the OTS, and the FDIC enforce this provision under section 8 of the FDI Act. The OCC, Board, and FDIC also have issued supervisory guidance to the institutions under their respective jurisdictions concerning unfair or deceptive acts or practices. See OCC Advisory Letter 2002–3—Guidance on Unfair or Deceptive Acts or Practices, March 22, 2002 and 12 CFR part 30, Appendix C; Joint Board and FDIC Guidance on Unfair or Deceptive Acts or Practices by State-Chartered Banks, March 11, 2004. OTS has also issued a regulation that prohibits savings associations from using advertisements or other representations that are inaccurate or misrepresent the services or contracts offered (12 CFR 563.27). The NCUA prohibits federally insured credit unions from using any advertising or promotional material that is inaccurate, misleading, or deceptive in any way concerning its products, services, or financial condition (12 CFR 740.2).

[8] Refer to 12 CFR part 34, subpart D (OCC); 12 CFR 208, subpart C (Board); 12 CFR part 365 (FDIC); 12 CFR 560.100 and 12 CFR 560.101 (OTS); 12 CFR 701.21 (NCUA).

[9] OTS Examination Handbook Section 212, 1–4 Family Residential Mortgage Lending, also discusses borrower qualification standards. Federally Insured Credit Unions should refer to LCU 04–CU–13—Specialized Lending Activities.

payment shock[10] and the ramifications of prepayment penalties, balloon payments, and the lack of escrow for taxes and insurance, as applicable. The Agencies strongly encourage institutions that impose prepayment penalties to structure them in such a way that they do not extend beyond the initial reset period and, further, provide borrowers a sufficient window of time immediately prior to the reset date to refinance without penalty.

Similarly, if borrowers do not understand that their monthly mortgage payments do not include taxes and insurance, and they have not budgeted for these essential homeownership expenses, they may be faced with the need for significant additional funds on short notice.[11] Therefore, mortgage product descriptions and advertisements should provide clear, detailed information about all of the costs, terms, features, and risks of the loan to the borrower. Consumers should be informed of:

- *Payment Shock.* Potential payment increases, including how the new payment will be calculated when the introductory fixed rate expires.
- *Prepayment Penalties.* The existence of any prepayment penalty, how it will be calculated, and when it may be imposed.[12]
- *Balloon Payments.* The existence of any balloon payment.
- *Cost of Reduced Documentation Loans.* Whether there is a pricing premium attached to a reduced documentation or stated income program.
- *Responsibility for Taxes and Insurance.* The requirement to make payments for real estate taxes and insurance in addition to their loan payments, if not escrowed, and the fact that taxes and insurance costs can be substantial.

Control Systems

Institutions should develop strong control systems to monitor whether actual practices are consistent with their policies and procedures. Systems should address compliance and consumer information concerns, as well as safety and soundness, and encompass both institution personnel and applicable third parties, such as mortgage brokers or correspondents.

Important controls include establishing appropriate criteria for hiring and training loan personnel, entering into and maintaining relationships with third parties, and conducting initial and ongoing due diligence with third parties. Institutions also should design compensation programs that avoid providing incentives for originations inconsistent with sound underwriting and consumer protection principles, and that do not steer consumers to these products to the exclusion of other products for which the consumer may qualify.

Institutions should have procedures and systems in place to monitor compliance with appropriate laws and regulations, applicable third-party agreements and internal policies. An institution's controls also should include appropriate corrective actions in the event of failure to comply with applicable laws, regulations, third-party agreements or internal policies. In addition, institutions should initiate procedures to review consumer complaints to identify potential compliance problems or other negative trends.

Supervisory Review

The Agencies will carefully scrutinize risk management and consumer compliance processes, policies, and procedures at regularly scheduled examinations. Institutions that do not adequately manage these functions will be asked to take remedial action. The Agencies will take action against institutions that fail to implement or adhere to safe and sound standards, exhibit predatory lending practices, or violate consumer protection laws, such as the Federal Trade Commission Act's prohibition against unfair or deceptive practices or the fair lending laws.

III. Request for Comment

The Agencies recognize that the structural evolution of subprime mortgage lending in recent years has introduced some products that are intended at their outset to be temporary credit accommodations in anticipation of early sale or refinancing, rather than longer-term amortizing accounts. Such loans typically involve terms that exceed the borrower's ability to service the debt without refinancing or selling the property. The motivations for these arrangements vary. They may include financing in anticipation of the borrower's intended temporary residency, expected future earnings growth, or need for a period of ''credit repair.'' Because of this fundamental shift in the purpose and actual repayment expectations of such loan programs, the Agencies are particularly interested in public comment on the following specific questions:

1. The proposed qualification standards are likely to result in fewer borrowers qualifying for the type of subprime loans addressed in this Statement, with no guarantee that such borrowers will qualify for alternative loans in the same amount. Do such loans always present inappropriate risks to lenders or borrowers that should be discouraged, or alternatively, when and under what circumstances are they appropriate?

2. Will the proposed Statement unduly restrict the ability of existing subprime borrowers to refinance their loans and avoid payment shock? The Agencies also are specifically interested in the availability of mortgage products that would not present the risk of payment shock.

3. Should the principles of this proposed Statement be applied beyond the subprime ARM market?

4. We seek comment on the practice of institutions that limit prepayment penalties to the initial fixed rate period. Additionally, we seek comment on how this practice, if adopted, would assist consumers and impact institutions, by providing borrowers with a timely opportunity to determine appropriate actions relating to their mortgages. We also seek comment on whether an institution's limiting of the expiration of prepayment penalties such that they occur within the final 90 days of the fixed rate period is a practice that would help meet borrower needs.

In addition to the foregoing questions, the Agencies request comment on all other aspects of the proposed Statement.

Dated: February 28, 2007.

John C. Dugan,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, March 2, 2007.

Jennifer J. Johnson,

Secretary of the Board.

Dated at Washington, DC, the 28th day of February, 2007.

By order of the Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

Dated: February 28, 2007.

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[10] To illustrate: A borrower earning $36,000 per year obtains a $200,000 ''2/28'' mortgage loan. The loan has a two-year introductory fixed interest rate of 7%, resulting in an initial payment of $1,331 and a 44% debt-to-income (DTI) ratio, based on principal and interest only; and would be higher after the inclusion of taxes and insurance. The spread is 6% over the six-month London Interbank Offered Rate (LIBOR), which is 5.5% at the time of loan origination. The fully indexed interest rate at origination of 11.5% (6% + 5.5%) would cause the borrower's monthly payment to increase to $1,956 (or 47%), a 65% DTI ratio, based on principal and interest only.

[11] Institutions generally can address these concerns most directly by requiring borrowers to escrow funds for real estate taxes and insurance.

[12] Federal credit unions are prohibited from charging prepayment penalties. 12 CFR 701.21.

By the Office of Thrift Supervision.

John M. Reich,

Director.

By the National Credit Union Administration on February 28, 2007.

JoAnn M. Johnson,

Chairman.

[FR Doc. 07–1083 Filed 3–7–07; 8:45 am]

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